SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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Here Now. Gone Tomorrow?

A strong 2Q89 U.S. equity market, propelled by M&A activity and a stable greenback, led to foreign net purchases of $4.5 billion of U.S. stocks, up more than ten-fold from the first quarter's $389 million. The increase in net purchases was accompanied by a 17.5% increase in gross transactions; from $91.8 billion in the 1Q to $107.9 billion in the 2Q.

U.S. investors exhibited similar behavior, making record 2Q net purchases of over $4.4 billion of foreign equities and increasing gross activity 2.2% to $51.6 billion. Of this, U.S. investors committed a record $3.3 billion to the U.K. market, which, despite numerous interest rate increases and a 14% base rate, somehow increased nearly 19% during the 1H89.

In terms of first half comparisons, foreign activity in the U.S. equity market was considerably brighter than the same period last year. During the 1H88, for instance, foreign investors totalled gross transactions of $192.1 billion and net sales of $168 million. First half 1989 totals show a slight 4% increase in gross activity, to $199 billion, but a substantial increase in net purchases to $4.9 billion. Moreover, we estimate that foreign trading accounted for about 14% of NYSE public trading in the 1H89, slightly below the levels of 1987-1988. Foreign ownership of U.S. equities outstanding climbed from 6.2% at the end of 1H88 to 6.6% by the 1H89.

Not to be outdone, U.S. investors entered unchartered territory. Net purchases of foreign equities at 1H89 totalled $6.1 billion, far surpassing the $292 million in net sales during the 1H88. Gross activity stood at $102 billion, over a 44% increase when compared to the 1H88 total of $70.8 billion. Further, this would put U.S. gross transactions in foreign equities at $200 billion on an annualized basis.

Leading the Way

Investors from Japan, OPEC and the U.K. alone made net purchases of U.S. equities totalling $4.5 billion in 2Q89, exceeding the net purchases of all foreign investors by $42 million. The Japanese commitment to the U.S. market, at $1.9 billion, was propelled by two main factors. First, continued political problems with the Recruit scandal and the implementation of a consumption tax kept a lid on any upward movement in Japanese equities as prices declined 1.6%. Secondly, confidence in a stable U.S. dollar, combined with a perception that lower yields on U.S. bonds (higher bond prices) would not be soon coming, made investment in U.S. equities attractive. Official data from the Ministry of Finance suggests that net activity in the third quarter will also be positive, albeit more subdued.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1989		*SECOND QUARTER 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q89-1Q89*
EUROPE	**$47,224**	**($154)**	**$53,375**	**$329**	**13.0%**
BELGIUM-LUXEMBOURG	2,920	(12)	3,632	(210)	24.4%
FRANCE	3,365	266	4,167	31	23.8%
GERMANY	4,082	148	4,230	(354)	3.6%
NETHERLANDS	1,753	69	1,964	(48)	12.0%
SWITZERLAND	10,410	(1,434)	11,234	(548)	7.9%
UNITED KINGDOM	22,219	767	25,196	1,112	13.4%
CANADA	**10,331**	**1,089**	**11,223**	**27**	**8.6%**
LATIN AMERICA & CARIBBEAN	**12,220**	**1,806**	**15,535**	**659**	**27.1%**
BERMUDA	2,311	485	2,797	393	21.0%
NETHERLANDS ANTILLES	4,247	999	4,643	19	9.3%
ASIA	**20,214**	**(1,299)**	**25,931**	**3,403**	**28.3%**
HONG KONG	2,174	56	2,401	(31)	10.4%
JAPAN	12,826	(1,508)	13,787	1,869	7.5%
OIL EXPORTING COUNTRIES	4,233	385	8,680	1,560	105.1%
TOTAL ALL COUNTRIES*	**$91,639**	**$389**	**$107,901**	**$4,499**	**17.5%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

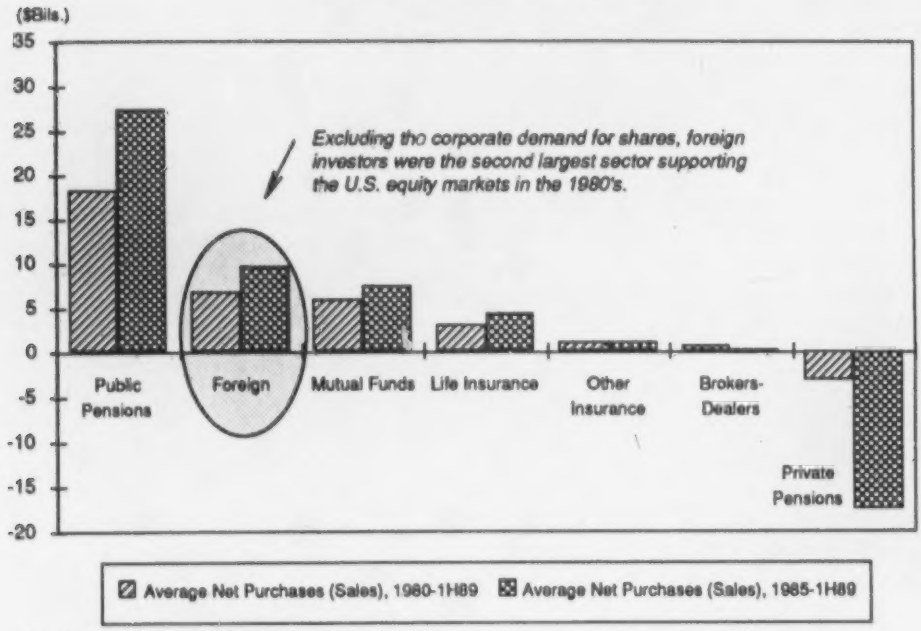
While the Japanese have returned to the U.S. equity market, it has been on sharply lower volume. Consider that their 1H89 transactions totalled $26.6 billion, down by over half from last year's 1H88 total of $60.3 billion. Reduced volume may be a sign that Japanese institutional investors are confident that the future level of the dollar will be stable and a short-term trading strategy, with profits dependent on exchange rates, not necessary.

After two years of net sales of U.S. equities totalling near $4 billion, OPEC investors made net purchases for a second consecutive quarter. Their second quarter net purchases at $1.6 billion reflects relative stability in oil prices. Their 1H89 net purchases of near $2 billion exceeded that of any country.

Interestingly, both Japan and OPEC made substantial net purchases of U.S. equities in June, $1.1 billion and $1.7 billion respectively. The turmoil in China, in June, may have been a key force behind this investment, highlighting the U.S.' reputation as a "safe haven" for investment during times of political instability.

Finally, much has been noted about foreign investment and its impact on U.S. equity prices. While it is difficult to measure the impact of foreign buying and selling on U.S. equity prices, we believe data showing the supply and demand for U.S. equities helps develop a picture by which we can, at the least, show the increasing impact these investors have on U.S. equity prices. The graph below shows the acquisition of U.S. equities (at an annual rate) through the 1980s. If we exclude the demand for shares by corporations, foreign investors rank as the second largest sector in buying U.S. equities, averaging $6.6 billion annually throughout the 1980s. Moreover, if we look at the most recent five-year period, their average acquisition rate is almost $10 billion per year. The combined effect of the foreign investors' tendency to commit funds to the larger and more liquid stocks, and the reduction of the supply of these stocks, surely magnified the impact of their net acquisitions on U.S. equity prices. Foreign investors have become relatively more important in the 1980s, at the same time many traditional investors have backed away.

Investor Demand For U.S. Equities



Source: Goldman, Sachs & Co.

U.S. Treasuries: Play me or Trade me

After snapping up $20.4 of U.S. Treasuries in the 1Q89, central bank intervention and profit taking by investors limited 2Q89 net purchases to just under $1.4 billion. This follows five quarters of substantial activity, where foreign investors averaged quarterly net purchases of $13.8 billion.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

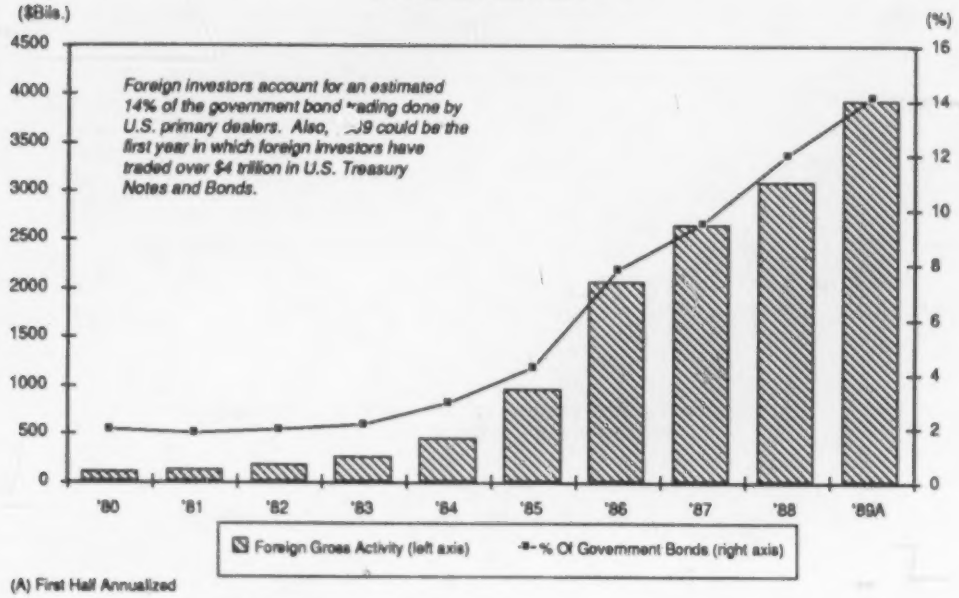
	FIRST QUARTER 1989		*SECOND QUARTER 1989*		*% CHANGE IN GA 2Q89-1Q89*
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	
EUROPE	**$368,946**	**$8,294**	**$401,901**	**$1,325**	**8.9%**
GERMANY	11,709	711	13,572	(1,978)	15.9%
SWITZERLAND	6,328	2,484	6,279	735	(0.8%)
UNITED KINGDOM	243,736	2,631	310,722	2,412	27.5%
ASIA	**423,323**	**12,205**	**605,995**	**(2,119)**	**43.2%**
JAPAN	356,737	4,467	519,354	(3,530)	45.6%
"OTHER ASIA"	26,073	6,280	34,485	(5)	32.3%
NONMONETARY INT'L & REGIONAL ORGANIZATIONS	**28,439**	**7**	**38,142**	**1,346**	**34.1%**
TOTAL ALL COUNTRIES*	**$862,473**	**$20,412**	**$1,103,511**	**$1,369**	**27.9%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

In the second quarter, with central banks shifting their concern from propping the dollar up to keeping a lid on its rise, official institutions made net sales totaling $1.3 billion. Concern about the dollar rise was particularly evident in Japan and Germany. Both countries raised the official discount rate and sold U.S. Treasuries. Net sales by Germany, totalled $2.0 billion, while Japan made net sales of $3.5 billion. In fact, the Bank of Japan experienced its first quarter-to-quarter decline in foreign exchange reserves since September 1985.

In contrast, private investors added U.S. Treasuries to their portfolios. With yields on long-term and intermediate U.S. bonds declining by 50-83 basis points during the second quarter, these investors made net purchases of $1.5 billion. However, this masks the behavior of foreign investors in June, when they were net sellers of $6.2 billion. Given the turmoil in China during this month, we find this data hard to explain, as we would have expected to see a "flight to safety." While some profit taking (U.S. governments returned 9.4% in the 1H89), and a shifting of assets to U.S. equities may have taken place during June, we believe this should not have led to substantial net sales of governments.

Foreign Activity In The U.S. Government Bond Market



(A) First Half Annualized

Source: U.S. Treasury; SIA estimates

Gross transactions in U.S. Treasury Notes and Bonds almost reached $2 trillion in the 1H89 alone. At an annualized rate, this activity will near $4 trillion in 1989 and account for over 14% of the trading in U.S. Treasuries. As an example of the tremendous growth in foreign trading of U.S. Treasuries, it is interesting to note that despite the 166% increase in foreign trading of U.S. equities during the 1980s, trading in U.S. Treasuries has increased from 53.8 % of total activity in U.S. securities to nearly 89% by the 1H89. Volatile exchange rates, the proliferation of derivative products, and the increasing amount of government debt outstanding, have contributed to the increased activity in these securities.

U.S. Activity in Overseas Equity Markets: Surprising Strength

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

	FIRST QUARTER 1989		*SECOND QUARTER 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q89-1Q89*
EUROPE	**$24,816**	**$1,152**	**$27,561**	**$4,609**	**11.1%**
FRANCE	1,393	147	1,518	266	9.0%
GERMANY	1,428	(26)	1,528	48	7.0%
NETHERLANDS	1,091	123	1,560	402	43.0%
SWITZERLAND	1,535	161	1,836	182	19.6%
UNITED KINGDOM	17,654	586	18,653	3,333	5.7%
CANADA	**2,226**	**108**	**2,655**	**241**	**19.3%**
ASIA	**20,107**	**667**	**17,073**	**(741)**	**(15.1%)**
JAPAN	18,168	730	14,512	(864)	(20.1%)
OTHER	**3,319**	**265**	**4,290**	**316**	**29.3%**
TOTAL ALL COUNTRIES*	**$50,473**	**$1,662**	**$51,579**	**$4,425**	**2.2%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

With ample opportunity in the U.S. equity market, one may have expected the U.S. investor to stay home. And, as the table below shows, U.S. investors could have done better by staying home, if early 1989 data were the only indices examined.

EQUITY MARKET RETURNS FOR U.S. INVESTORS
(U.S.$)

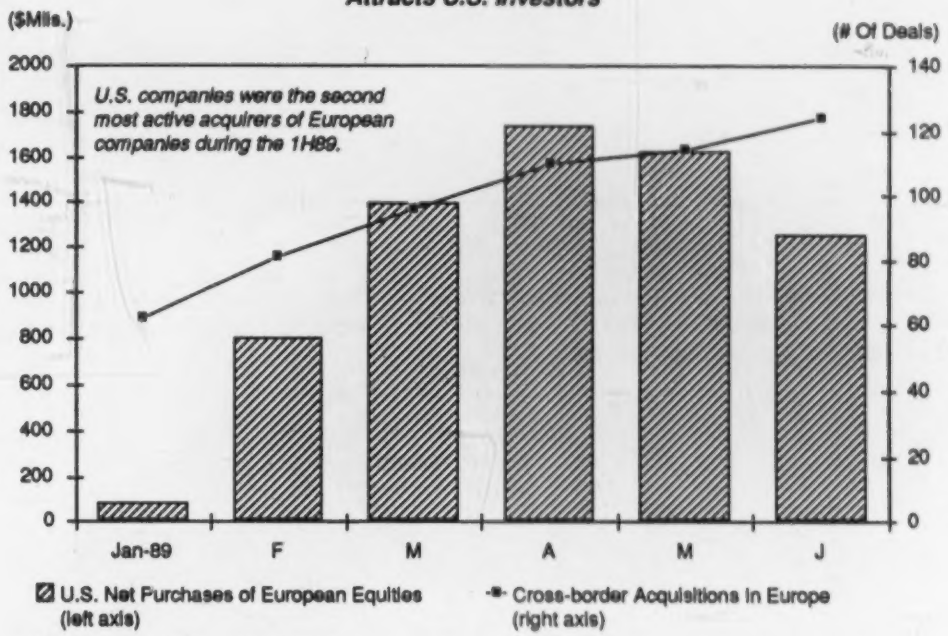
	% CHANGE 2Q89	*% CHANGE YTD*
EUROPE	**(0.2)**	2.1
FRANCE	2.9	3.2
GERMANY	7.2	0.9
NETHERLANDS	2.0	5.5
SWITZERLAND	8.1	2.6
UNITED KINGDOM	**(5.8)**	1.8
CANADA	4.3	11.6
ASIA	**(9.5)**	**(10.6)**
JAPAN	**(9.5)**	**(10.7)**
WORLD ex. U.S.	**(6.2)**	**(6.0)**
U.S.	8.0	14.6

Source: Goldman Sachs FT-Actuaries World Indices

But with a surge in European investment, U.S. investor net purchases of foreign equities totalled $4.4 billion in the second quarter. That puts 1H89 net purchases at $6.1 billion, the largest net accumulation U.S. investors have made in any time frame.

With U.K. takeover fever in high gear, U.S. net purchases of U.K. equities in the 2Q reached $3.3 billion, shattering the previous record of $1.3 billion in the 1Q87. In fact, M&A activity (on an announcement basis) in the U.K. reached a record $20.5 billion in the 2Q89. This includes a $7.7 billion bid by Smithkline for Beecham. Given that 3Q89 M&A activity was over $9 billion, some of the second quarter purchases may have been speculative in nature. However, unlike the 1Q89's 8.0% gain (U.S. $ terms), U.S. investors saw U.K. equity prices dip 5.8% as pressures from a deteriorating trade balance, high interest rates, and a slowing economy made their presence felt. More generally, we note that M&A activity in Europe was also at lofty levels in the 1H89, particularly in the U.K. and France. The graph below helps explain the extraordinary U.S. commitment to European equity markets, $5.8 billion in the 1H89.

M&A Activity in Europe Attracts U.S. Investors



Source: Financial Times; U.S. Treasury

In Japan, U.S. investors followed the lead of Japanese investors, taking profits and making net sales of $864 million. Such strategy proved wise as Japanese equities declined 9.5%, in dollar terms, during the 2Q. Further, U.S. investors in Japan have seen equity prices decline near 11% for the 1H89.

U.S. investors, after making net sales of $26 million of German equities, reversed their posture and made net purchases of $48 million. A strong U.S. dollar, coupled with GDP increasing at an annual rate of 3 1/2% during the 1H, boosted U.S. enthusiasm for German equities. In dollar terms, U.S. investors saw German equity prices gain 7.2% in the 2Q.

While not generally followed in this report, the substantial investment that U.S. investors have made in Spanish equities is interesting. First half 1989 net purchases of these equities totalled $391 million. Compared to U.S. net acquisitions of $413 million in France and $525 million in the Netherlands, U.S. interest in Spanish stocks was not minimal. If we look at U.S. activity in Spain for the year-ending

June 1989, the result is even more surprising. U.S. investors made net purchases of $640 million of Spanish equities during this period; this was only exceeded by U.S. net purchases of $5.4 billion in the U.K.

Net Purchases of European Equities By U.S. Investors
(June '88 - June '89)

Country	*Net Purchases ($Mils.)*	*% of Market Capitalization** (As at 6/31/89)
U.K.	$5,357	1.3%
Spain	640	1.2
France	557	0.4
Italy	341	0.4
Switzerland	299	0.3
W. Germany	296	0.2
Netherlands	209	0.3
Total	$7,699	0.8%

*Market capitalization figures supplied by Morgan Stanley Capital International Perspective (EAFE)

To estimate the impact of this investment, we looked at U.S. equity investment as a percent of equity market capitalization. Again, we find that the impact of U.S. investment in Europe was greatest in the U.K., with Spain not far behind. This is shown in the table above. The significant capital inflow is consistent with Spain's rapid economic expansion in the past two years. OECD data indicate GDP growth of over 5% and gross fixed capital formation of over 14%, making Spain among the fastest growing OECD countries. In addition, much interest was built in anticipation of major reforms to be made to the Spanish equity market in July of this year. We believe the "Spanish Story" has been overlooked by market observers over recent periods.

David G. Strongin
Director, International Finance

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1989		*SECOND QUARTER 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q89-1Q89*
EUROPE	**$13,982**	**$4,080**	**$17,345**	**$4,205**	**24.1%**
BELGIUM-LUXEMBOURG	585	(111)	545	(181)	(6.8%)
FRANCE	457	143	533	119	16.6%
GERMANY	757	217	1,139	(95)	50.5%
SWITZERLAND	820	262	1,092	(140)	33.2%
UNITED KINGDOM	10,372	3,390	12,910	3,922	24.5%
ASIA	**6,703**	**323**	**10,063**	**(967)**	**50.1%**
JAPAN	5,226	(142)	7,739	(855)	48.1%
"OTHER ASIA"	988	220	1,404	520	42.1%
TOTAL ALL COUNTRIES*	**$23,948**	**$5,594**	**$32,739**	**$4,001**	**36.7%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$34,616**	**$(216)**	**$52,377**	**$5,761**	**51.3%**
FRANCE	1,758	258	2,911	413	65.6
GERMANY	2,419	(35)	2,956	22	22.2
NETHERLANDS	1,706	110	2,651	525	55.4
SWITZERLAND	2,453	565	3,371	343	37.4
UNITED KINGDOM	23,347	1,035	36,307	3,919	55.5
CANADA	**5,883**	**(111)**	**4,881**	**349**	**(17.0)**
ASIA	**25,966**	**356**	**37,180**	**(74)**	**43.2**
JAPAN	23,497	569	32,680	(134)	39.1
OTHER	**4,356**	**(321)**	**7,609**	**581**	**74.7**
TOTAL ALL COUNTRIES*	**$70,821**	**$(292)**	**$102,052**	**$6,087**	**44.1%**

Source: U.S. Treasury

* Total activity incorporates revised data; country activity does not include revisions.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$596,751**	**$15,885**	**$770,847**	**$9.619**	**29.2%**
GERMANY	31.306	3.776	25.281	(1.267)	(19.2)
SWITZERLAND	11.464	262	12.607	3.219	10.0
UNITED KINGDOM	407.271	5.696	554.458	5.043	36.1
ASIA	**774,694**	**16,874**	**1,029,318**	**10,086**	**32.9**
JAPAN	663,836	15,719	876,091	937	32.0
"OTHER ASIA"	37,850	(528)	60,558	6,275	60.0
NONMONETARY INT'L & REGIONAL ORGANIZATIONS	**117,642**	**$1,090**	**66,581**	**$1,353**	**(43.4)**
TOTAL ALL COUNTRIES*	**$1,604,215**	**$38,952**	**$1,965,984**	**$21,781**	**22.6%**

Source: U.S. Treasury

* Total activity incorporates revised data: country activity does not include revisions.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$79,799**	**$(1,545)**	**$100,599**	**$175**	**26.1%**
BELGIUM-LUXEMBOURG	4,225	227	6,552	(222)	55.1
FRANCE	6,238	(165)	7,532	297	20.7
GERMANY	5,626	203	8,312	(206)	47.7
NETHERLANDS	3,438	(480)	3,717	21	8.1
SWITZERLAND	18,087	(867)	21,644	(1,982)	19.7
UNITED KINGDOM	37,778	(736)	47,415	1,879	25.5
CANADA	**16,351**	**91**	**21,554**	**1,116**	**31.8**
LATIN AMERICA & CARIBBEAN	**18,605**	**249**	**27,755**	**2,465**	**49.2**
BERMUDA	3,472	22	5,108	878	47.1
NETHERLANDS ANTILLES	6,066	150	8,890	1,018	46.0
ASIA	**73,349**	**933**	**46,145**	**2,104**	**(37.1)**
HONG KONG	3,771	(220)	4,575	25	21.3
JAPAN	60,256	2,616	26,613	(361)	(55.8)
OIL EXPORTING COUNTRIES	6,937	(1,396)	12,913	1,945	86.1
TOTAL ALL COUNTRIES*	**$192,116**	**$(168)**	**$199,740**	**$4,888**	**4.0%**

Source: U.S. Treasury

* Total activity incorporates revised data, country activity does not incorporate revisions.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS BY FOREIGN INVESTORS

($Mils.)

	FIRST HALF 1988		*FIRST HALF 1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1H88-1H89*
EUROPE	**$23,901**	**$6,079**	**$31,327**	**$8,285**	**31.1%**
BELGIUM-LUXEMBOURG	1,028	8	1,130	(292)	9.9
FRANCE	1,163	81	990	262	14.9
GERMANY	2,153	753	1,896	122	11.9
SWITZERLAND	1,995	(8)	1,912	122	(4.2)
UNITED KINGDOM	15,850	4,916	23,282	7,312	46.9
ASIA	**11,063**	**1,888**	**16,766**	**(644)**	**51.6**
JAPAN	9,323	1,921	12,965	(997)	39.1
"OTHER ASIA"	975	197	2,392	740	145.3
TOTAL ALL COUNTRIES*	**$40,273**	**$8,887**	**$56,687**	**$9,595**	**40.8%**

Source: U.S. Treasury

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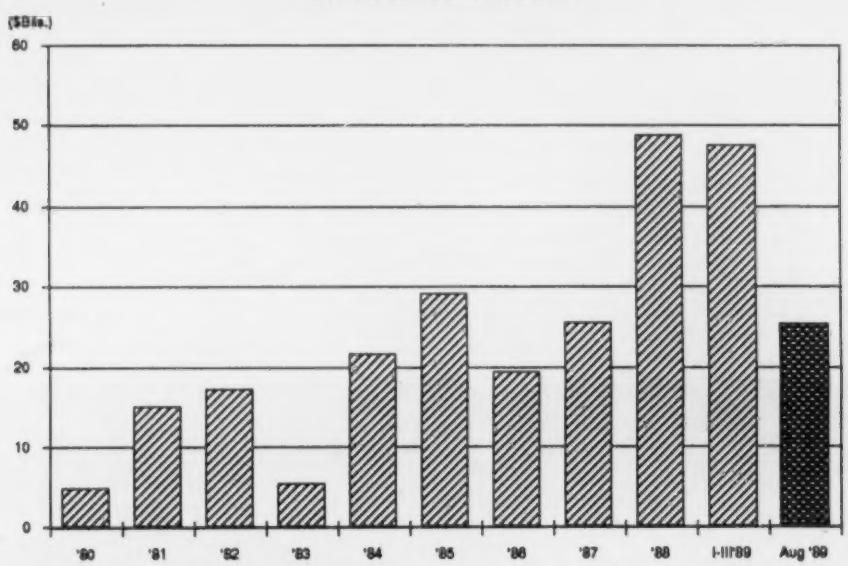
When One Month Makes A Year

Once in a while, we are reminded of the enormous amounts of worldwide capital which is free to be invested. August was such a reminder. In August alone, foreign investors made net purchases of an unprecedented $22 billion in U.S. Treasury Bonds and Notes; and over $25 billion for the 3Q89. In comparison, just consider, until 1985 the largest net purchase total for a year was $21.5 billion (1984). Both official institutions and private investors took part, making net purchases in August of $10 billion and $12 billion. U.K. investors made net purchases of $11.2 billion, while German investors and OPEC made net acquisitions of $5.6 billion and $4.8 billion, respectively. Surprisingly, Japanese investors -- major buyers of Treasuries in the past -- were net sellers in the 3Q89.

Net Investment in U.S. Treasuries

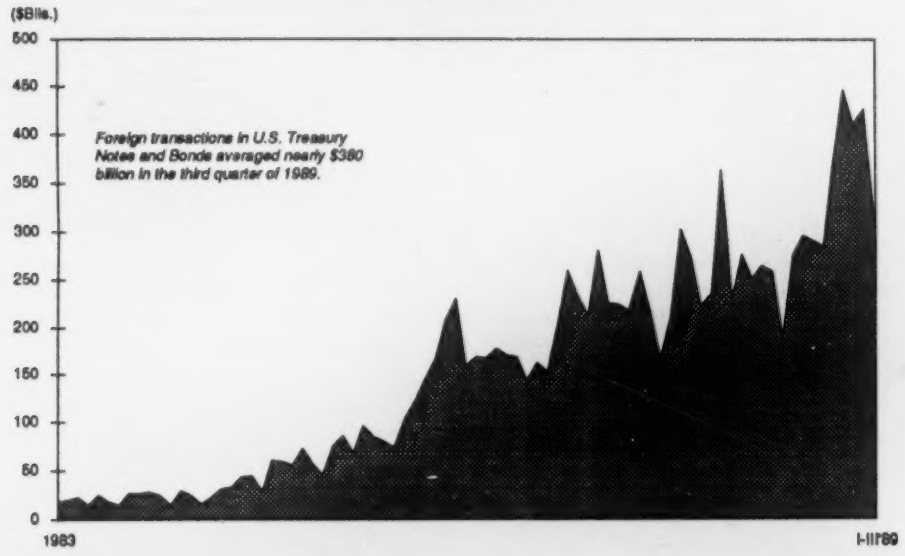


While the reasons for the investment in U.S. Treasury bonds are plenty, none seems particularly compelling enough to account for this massive inflow of capital. Among the factors were the recovery of the Dow to a record high, an improving trade outlook, an increase in the U.S. government's statutory debt limit for the first time since September 1987, a Fed decision not to withhold or delay primary dealerships from foreign firms, and evidence from the Fed's "Beige Book" showing a "soft landing" for the U.S. economy.

We discussed the magnitude of the August number with the U.S. Treasury. While data are preliminary, Treasury informed us that the August number was, after checking, accurate.

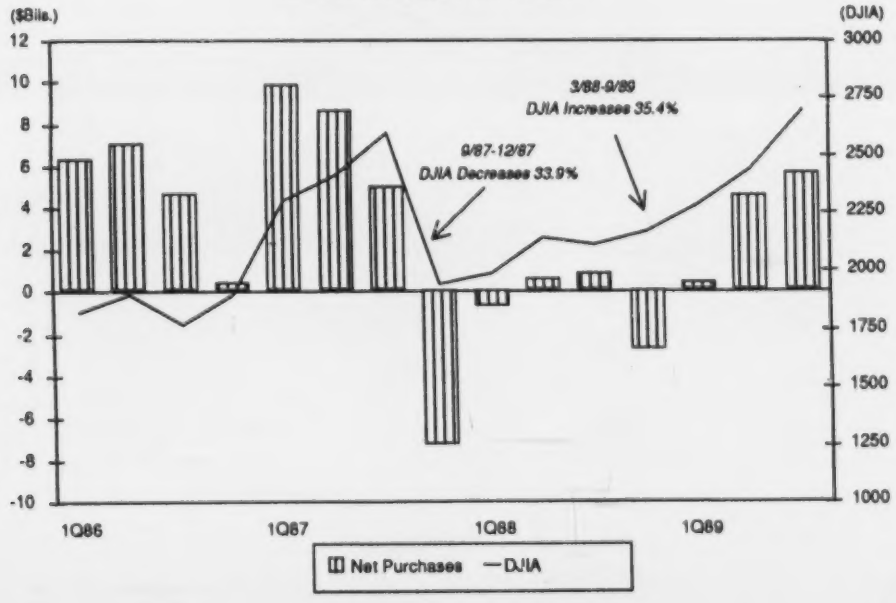
In addition, instead of the usual summer doldrums, gross transactions reached near record heights during the 3Q89, with August's activity topping $426 billion; just below the $446 billion traded in July. Moreover, August's activity exceeded any year's activity prior to 1984's $450.7 billion.

Gross Transactions in U.S. Treasury Bond & Notes



Unusually high activity was also exhibited by U.S. primary dealers, exceeding $140 billion on a daily basis for the first two and one half weeks in August. The strength in activity may have been in response to some economic reports in August, which indicated, unlike the Fed's "Beige Book", that the U.S. economy was healthier than previously thought.

Foreign Investors Commit Increasing Amounts Of Capital To U.S. Equities



Capital inflows were not limited to Treasury notes and bonds. As the Dow broke through pre-crash highs, equities, too, attracted foreign interest, reaching pre-crash levels. Net purchases in the 3Q89 totalled $5.7 billion, a level not exceeded since the $8.6 billion in 2Q87. From 1986 through the first three quarters of 1987, net purchases averaged $6.2 billion per quarter. In sharp contrast, foreign investors averaged quarterly net sales of $626 million from 4Q87 to 2Q89. While fourth quarter data is not available, it will be interesting to see what lesson, if any, foreign investors learned from the 1987 Crash. Those, who used the ensuing months in 1987-88 to purchase "marked-down" equities, profited handsomely.

More details will be available in the complete 3Q89 *Foreign Activity Report.*

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SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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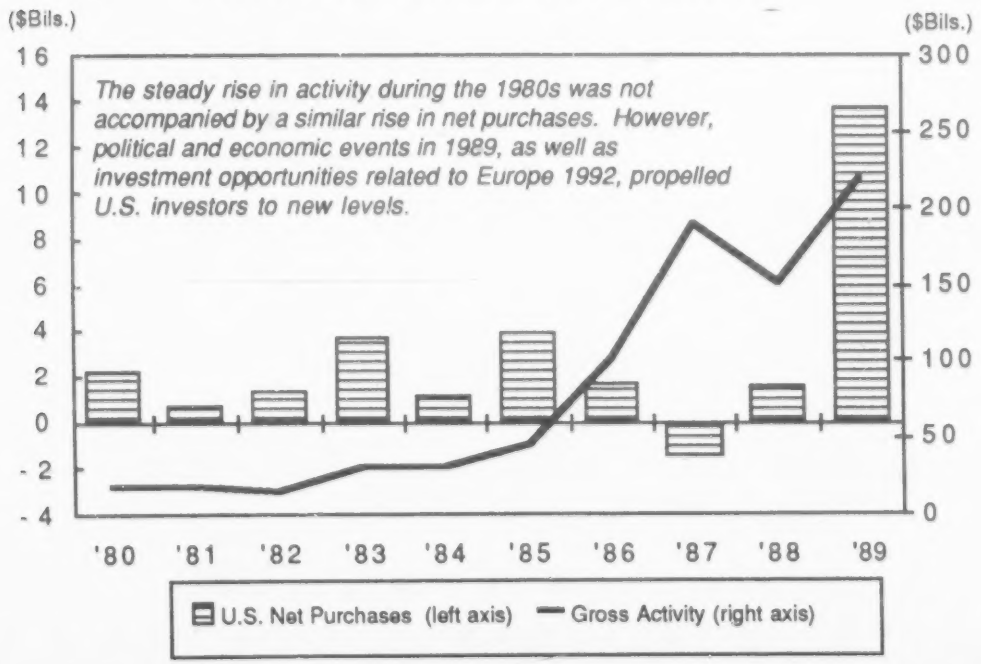
Maybe Foreign Markets Aren't So Foreign Anymore

With a strengthening U.S. dollar easing the way, political and economic transformations around the world, particularly in Europe, led U.S. investors to make net purchases of a record *$13.7 billion* in 1989. The 1989 total is some three and one-half times greater than the previous high of *$3.9 billion* in 1985. Interestingly, 1989 is the only year during the 1980s that U.S. net purchases of foreign equities exceeded foreign net purchases of U.S. equities. (In 1984 and 1988, foreign investors made net sales.) Moreover, gross transactions in 1989 totalled a record $220 billion, a 16% increase over 1987's record $190 billion. The increased U.S. commitment to foreign equities took place while world equity markets (excluding the U.S.) posted a modest 10.3% gain. Contrasted with the 26% increase in the U.S. market, we contend that the unparalleled nature of this investment is for longer-run considerations.

1989: The Year Of The U.S. Equity Investor



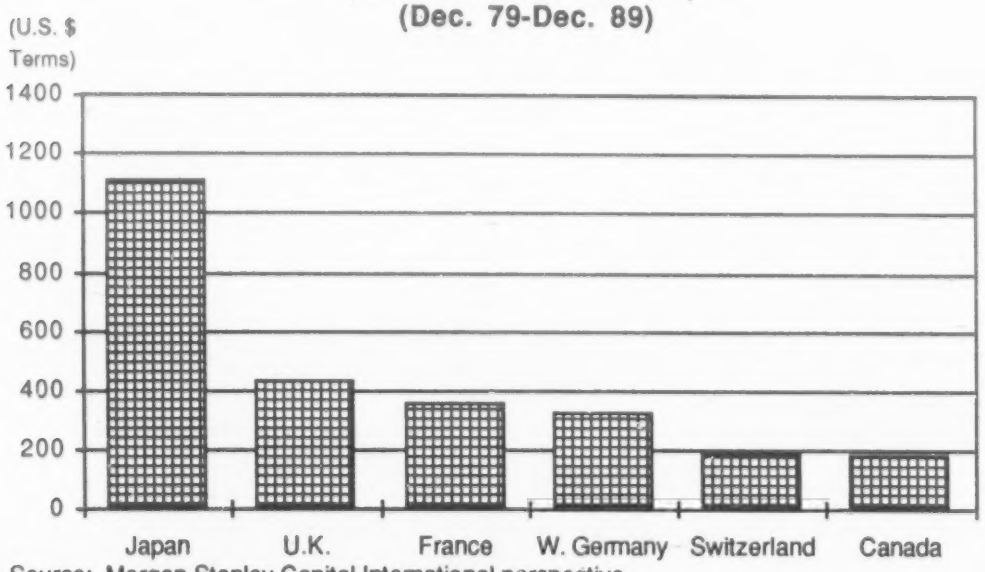
On a quarterly basis, U.S. investors made $4.27 billion of net purchases in the fourth quarter, nearly equalling the record $4.29 billion made in 2Q89. As the Yen weakened, increased U.S. purchasing power led to a $1 billion commitment to the Japanese equities. With the Tokyo market under pressure from rising interest rates, we believe the activity in the Japanese market represented a buying opportunity for those U.S. investors underweighted in Japanese stocks.

Spurred on by rapidly moving events in Europe, U.S. investors made net purchases of $2.5 billion in Europe in 4Q89. New highs were reached in France, $474 million, and West Germany, $555 million; M&A activity in the former, and developments in Eastern Europe in the latter, played no small part in attracting these flows. Perhaps of more interest are indications of the U.S. investors' interest in all EC equities. In 1989, net purchases of equities in EC Member States totalled $8.9 billion, exceeding 1987's previous record of $2.8 billion. In addition, U.S. investors also increased direct investment into Europe. On an annualized basis, U.S. investors increased their direct investments in the EC by some $16 billion; this compares to $4.4 billion in 1988. So while EC 1992 might seem distant to some, U.S. investors are clearly gearing up to benefit from this new economic powerhouse.

The Decade That Was

With the decade closed, it is interesting to compare the allocation of U.S. funds to overseas equity markets to the performance, in U.S. dollars, of these markets. From 1980 to 1989, U.S. investors made net purchases of over $25 billion of foreign equities. Over half of these, net purchases, however, were made in 1989 alone.

Increase in Foreign Equity Market Prices
(Net Dividends Included)
(Dec. 79-Dec. 89)



Source: Morgan Stanley Capital International perspective

The U.K. was the main recipient of U.S. equity investment, with equity investments totalling $11.8 billion (or 47% of total net equity investment). Despite the

meteoric rise of Japanese stocks since 1980, U.S. investors lost out for the most part, making sales of nearly $4 billion.

Canadian equities were the second largest recipient of U.S. dollars during the 1980s, with net investment of $5.2 billion. Swiss stocks, also attracted U.S. attention, with net purchases equalling about $3.8 billion. U.S. investment in Swiss stocks was fairly steady throughout the 1980s, with U.S. investors making net sales in just five quarters, less than that of any other major country. In light of the restrictions on ownership of Swiss stocks by foreign investors, we find this of interest and believe U.S. investment would increase with the elimination of restrictive practices. Finally, French equities also attracted $3.0 billion in U.S. funds.

When we compared U.S. investment flows to the increase in overseas equity prices (U.S. dollars), we noticed that the market which performed the best, the Japanese market, was the only major market in which U.S. investors withdrew funds. For the record, the Japanese market increased by over 1100% in the 1980s, or at a compound annual growth rate of 28%. Nevertheless, while a poor investment decision for the 1980s, this posture appears prudent given current events in the Tokyo markets which have forced Japanese stocks down by over 30% (U.S. $ Terms) since the beginning of the year.

The beneficiary of the lion's share of U.S. capital was the U.K. equity market, which increased over 430% in the 1980s; not bad, but far behind the Japanese market. U.S. investors in Canadian equities received a relatively disappointing 178% increase in the 1980s, the smallest increase among the six countries analyzed.

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Foreign Activity

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May 4, 1990

THE YEAR THAT WAS: 1989

The only thing predictable about 1989 was that neither the Chicago Cubs nor the Boston Red Sox would win the World Series. Otherwise, only a gaze into, you know whose, crystal ball may have given us any clues on what was to come.

First on the unpredictable side was OPEC's sudden resurgence in the U.S. capital markets. Supported by higher oil prices, these investors made net purchases of $3.6 billion of equities and over $8 billion in U.S. Treasuries.

Second, activity in 1989 proves that the 1987 market crash did not have a long-term chilling impact on cross-border equity investment.

Third, net overseas equity purchases by U.S. investors totalled almost $13.7 billion in 1989, by far a record high. U.S. holdings of foreign equities now totals close to $100 billion.

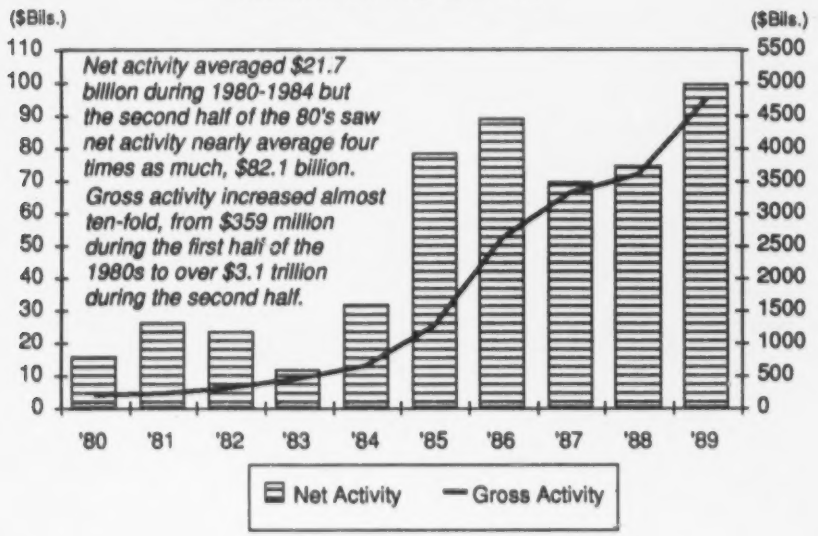
Finally, the theme that developed over the course of 1989 was the increasing amount of capital that will be demanded. The movement toward EC 1992 and changes in Eastern Europe critically alter the supply and demand for capital equation. All other things being equal, the future demand for capital may well exceed the available supply. The impact on global interest rates is an unsettling thought, and the worldwide rise in interest rates may be hard pressed to move back down.

Foreign Investment In U.S. Securities: Not A Bad Way To End A Decade

It has been two and one-half years since the crash of 1987, and, at least in the broadest sense, the crash seems to have had little lasting impact on most foreign investors. For the first time, gross activity in U.S. securities exceeded $4 trillion, reaching $4.8 trillion. Portfolio flows into the U.S. in 1989 neared $100 billion, $99.2 billion to be exact. The 1989 total eclipses the previous high of $88.8 billion in 1986 and far exceeded 1988's inflow of $74.8 billion. As we'll note later, though, worldwide events may make the supply of foreign capital less available to service the U.S. deficit.

However, the foreign investors' preference for U.S. equities continues to lag the 1986 and 1987 levels, when net purchases of U.S. equities accounted for 22% of net foreign flows. In 1989, net equity purchases were about half the size of the 1986-1987 share, or 10.5%.

Portfolio Investment in U.S. Securities Reached New Heights in 1989



What A Difference A Year Makes: Foreign Investors Come "Home"

After making net sales of $2 billion in 1988, foreign investors returned to the U.S. equity market in style. While the year ended on a down note — 4Q89 saw net sales of $400 million — the yearly total of $10.4 billion is the third highest level ever, compared to 1986's record $18.7 billion and 1987's $16.3 billion. Gross transactions in 1989 neared $417 billion, or a quarterly average of $104 billion. While still below 1987's peak of $480 billion, the 1989 total represented a welcome 14.3% increase in transaction volume over 1988's $364 billion. With interest rates declining, stock prices increasing, and the dollar strengthening, many foreign investors were able to put most of their misgivings behind, further strengthening the notion that the 1987 crash did not cause irreparable harm to international investing.

The increased commitment to U.S. equities came from all major geographic regions. Despite keen U.K. interest in U.S. equities, net purchases from Europe totalled slightly over $1 billion, as many European countries showed no interest in acquiring U.S. equities. Investors from France and Germany, concentrating on domestic events, made net sales of $700 million and $865 million, respectively. It didn't hurt that, in local terms, French equities posted a nearly 30% return while German stocks rose over 34% in price.

Investors from Switzerland remained divestors of U.S. equities, making net sales of $1.2 billion in 4Q89, and near $3.5 billion for the year. However, investors from the U.K. more than made up for the European sell-off, making net purchases of $4.5 billion. We suspect that high cash levels among institutions resulting from record levels of M&A activity, the specter of rising U.K. interest rates and a strong U.S. equity market contributed to this surge.

Both Japanese investors and OPEC showed an appetite for U.S. equities. Investors from Japan added an additional $3.3 billion to their U.S. equity portfolios, matching their 1986 total. Share prices in Tokyo increased by nearly 19% (local terms) in 1989 while the Yen weakened over the year, from ¥125 to the dollar to ¥143.8. Domestic political problems and rising Japanese interest rates provided impetus for money to flow to the U.S.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	1988		*1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1988-1989*
EUROPE	**$154,152**	**($3,423)**	**$203,790**	**$1,010**	**32.2%**
BELGIUM-LUXEMBOURG	7,738	134	14,044	346	81.5%
FRANCE	12,028	(281)	15,620	95	29.9%
GERMANY	10,966	223	15,747	(592)	43.6%
NETHERLANDS	5,828	(535)	7,387	6	26.8%
SWITZERLAND	34,909	(2,242)	32,934	(3,483)	(5.7%)
UNITED KINGDOM	73,235	(1,034)	97,217	4,507	32.7%
CANADA	**33,941**	**1,088**	**45,397**	**(867)**	**33.8%**
LATIN AMERICA & CARIBBEAN	**38,301**	**1,248**	**61,343**	**3,049**	**60.2%**
BERMUDA	6,663	55	12,701	1,329	90.6%
NETHERLANDS ANTILLES	12,729	385	18,568	744	45.9%
ASIA	**129,624**	**(1,104)**	**97,974**	**6,869**	**(24.4%)**
HONG KONG	6,876	(250)	9,021	139	31.2%
JAPAN	104,601	1,923	60,769	3,255	(41.9%)
OIL EXPORTING COUNTRIES	14,143	(2,466)	23,899	3,591	69.0%
TOTAL ALL COUNTRIES*	**$363,965**	**($2,062)**	**$416,333**	**$10,163**	**14.4%**

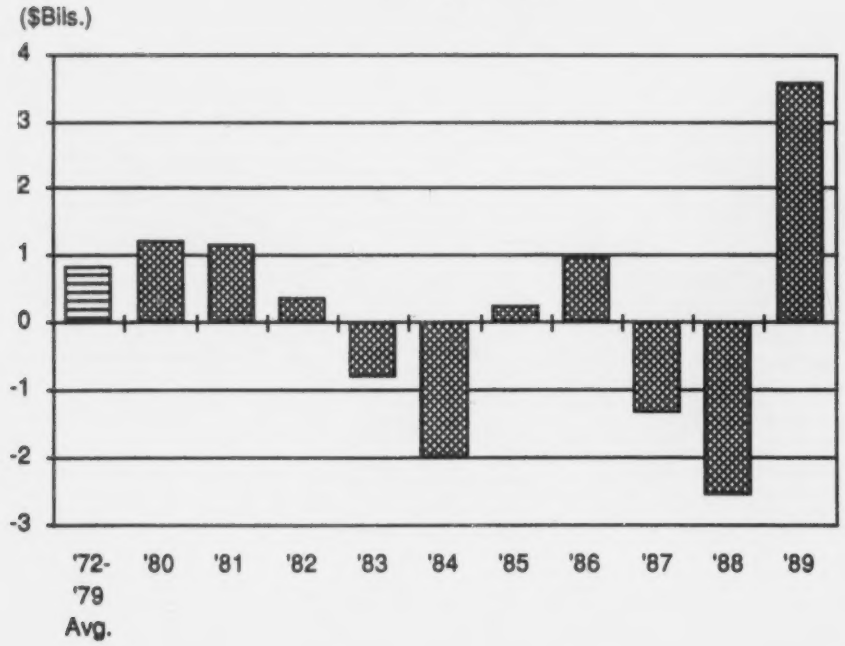
Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

We believe that the relatively small investment by Japanese investors in U.S. equities may be a result of the increased emphasis on direct investment in the U.S., as well as other European investment opportunities. Japanese balance of payments data supports this theory. In 1987, 48% of Japanese net purchases of foreign securities was made in the EC; by the 1H89, this percentage had risen to over two-thirds. In sharp contrast, net investment in U.S. securities by Japanese investors, which accounted for 43% of net flows in 1987, more than halved to just over 20% at the 1H89. Coupled with

the current turmoil in the Tokyo market, capital flows from Japan to the U.S. may be at reduced levels in future years. We suspect that the Tokyo stock market collapse may force Japanese investors to use the strengthening dollar to build Yen cash positions to cover open positions in the home market.

Investors from OPEC, benefiting from higher oil prices and increased demand, made record net purchases of near $3.6 billion, nearly double their 1976 record of $1.8 billion. OPEC's investment marks a sharp reversal from the past two years, when net sales of $4.0 billion were made in response to the collapse in world oil prices. Overall in the 1980s, these investors were net purchasers of over $800 million of U.S. equities; in contrast, OPEC made net purchases of over $6.5 billion during the 1970s.

OPEC Net Purchases Of U.S. Equities Soar To Nearly $3.6 Billion



Swiss investors made net sales in each quarter of 1989 (as well as in 1988) for a total net sales posture of $3.5 billion, their largest yearly divestment ever. The memory of the October 1987 crash seems to have lingered with Swiss investors and the 24% gain in Swiss equity prices in 1989 got the attention of Swiss investors. Starting with the 4Q87, these investors have made net sales for nine consecutive quarters, totalling nearly $7.8 billion. We believe that for the most part, the Swiss have reinvested this money in Swiss securities, particularly fixed-income products. Steadily rising Swiss rates since 1988, most notably on short-term instruments, have given these investors the opportunity to "lock-in" yields with no currency risk. For instance, the three month

deposit rate, which averaged 1.5% in 1Q88, averaged 7.5% in 4Q89. With Swiss investors still troubled by the events of October 1987, high domestic interest rates and events in Germany only compounded the negative posture these investors have taken in the U.S. equity market and may auger a smaller Swiss role in the U.S. equity markets.

While waiting for a firm trend to develop, the emergence of an integrated European common market and the market-reform policies of Eastern Europe may displace flows otherwise earmarked for U.S. equities. We note two examples. First, the record number of European merger and acquisitions resulting from the need to enhance competitiveness come 1992 have almost certainly siphoned European funds ordinarily invested in the U.S. market. According to one recent study (Translink's European Deal Review), European M&A activity was near $52 billion in 1989, with the most active acquiring companies from Europe located in the U.K., France, West Germany and Italy.

Second, the substantial foreign flows into the West German securities markets, with net equity purchases totalling over a record $12 billion in 1989, also indicate foreign investor interest in playing the "Eastern Europe Card". Moreover, German investors will likely supply less capital abroad as they concentrate on rebuilding East Germany, where estimates as high as $500 billion have been put on the rebuilding of this country. Recent ventures, such as Deutsche Bank's acquisition of an East German Bank's branch network, underscore this point. In the 1990s, these new investing opportunities and obligations may lessen the support that foreign investors give to the U.S. equity markets specifically, and securities markets generally.

For instance, continued growth in the emerging markets could also attract capital. A recent study by The World Institute For Development Economics Research estimates that by the end of the century, foreign investment in emerging markets markets could increase by over six-fold; from $15 billion in 1989 to $100 billion in the year 2000.

And, given the need for capital in Europe, the available supply of foreign capital for the U.S. does not seem to be keeping pace with a growing demand. That other nations are now in need of enormous capital infusions should concern U.S. policy makers legislating proposals affecting foreign capital.

U.S. Treasuries: Foreign Investment Moves To Another Level

In 4Q89, gross activity dipped to $1 trillion, down from the record $1.1 trillion in 3Q89, while net purchases reached $7.3 billion. The 4Q89 totals pushed both gross and net activity to records levels, $4.1 trillion and $54.5 billion, respectively. Net purchases by foreign investors accounted for over 50% of the year-to-year increase in Treasury bonds and notes outstanding, while trading activity was equivalent to over 14% of the activity of U.S. primary dealers.

The private sector made record net purchases of $25.8 billion in 1989, topping the

previous high of $21.5 billion reached in 1988. Declining U.S. interest rates, a stable to increasing dollar, and worldwide political change made U.S. Treasuries particularly attractive in 1989. Official institutions (central banks) made net additions of $26.9 billion, a slight gain over the previous year's $26.6 billion.

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

	1988		*1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1988-1989*
EUROPE	**$1,163,593**	**$14,255**	**$1,557,059**	**$36,217**	**33.8%**
GERMANY	79,706	(5,348)	57,199	7,913	(28.2%)
SWITZERLAND	24,487	(1,074)	30,047	2,200	22.7%
UNITED KINGDOM	798,901	9,667	1,106,140	20,425	38.5%
ASIA	**$1,457,103**	**$27,357**	**$2,198,065**	**$13,913**	**50.9%**
JAPAN	1,238,009	21,753	1,886,989	2,311	52.4%
"OTHER ASIA"	81,370	1,715	115,288	8,501	41.7%
NONMONETARY INT'L & REGIONAL ORGANIZATIONS	**$246,117**	**$686**	**$148,045**	**$2,171**	**(39.8%)**
TOTAL ALL COUNTRIES*	**$3,083,732**	**$48,529**	**$4,121,818**	**$54,525**	**33.7%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

The most interesting story in this market is the return of OPEC investors to U.S. Treasuries. Despite a sell-off of $2.6 billion in 4Q89, OPEC net purchases of Treasuries totalled $8.5 billion for the year. Not surprisingly, the flows into the U.S. have coincided with OPEC's slightly improving trade balance with the U.S. This increase in capital flows from OPEC to the U.S. market, may to some extent, replace those flows from Japanese and European investors which have been re-directed to Europe.

U.S. Investment In Foreign Equities: The Wave Of The Future?

As noted in an earlier issue of *FAR*, U.S. investors were star performers last year. With a strengthening U.S. dollar easing the way, political and economic transformations around the world, particularly in Europe, led U.S. investors to make net purchases of a record $13.7 billion. Moreover, gross transactions in 1989 totalled a record $220 billion, a 16% increase over 1987's record $190 billion, and an impressive 45.7% increase over 1988's $150.8 billion. In sharp contrast, volume on the NYSE increased only 2.7%.

Buoyed by European events, U.S. investors made net commitments of over $10.5 billion to European equities markets; of this, $8.9 billion went to the EC. And why not.

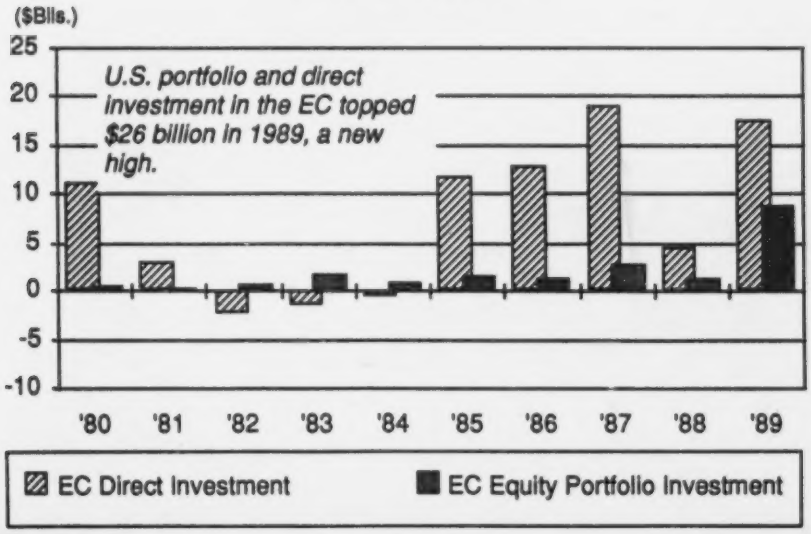
GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

	1988		*1989*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1988-1989*
EUROPE	**$75,445**	**$1,279**	**$116,789**	**$10,531**	**54.8%**
FRANCE	4,008	402	6,497	1,115	62.1%
GERMANY	4,525	239	6,215	861	37.3%
NETHERLANDS	3,974	(206)	6,051	1,213	52.3%
SWITZERLAND	5,309	521	7,913	1,381	49.0%
UNITED KINGDOM	51,213	403	79,694	4,642	55.6%
CANADA	**9,845**	**(477)**	**10,839**	**1,271**	**12.4%**
ASIA	**55,846**	**822**	**75,707**	**825**	**35.6%**
JAPAN	40,158	634	65,748	1,044	63.7%
OTHER	**9,906**	**(110)**	**14,531**	**1,039**	**46.7%**
TOTAL ALL COUNTRIES*	**$150,842**	**$1,514**	**$219,791**	**$13,683**	**45.7%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Returns (U.S. dollar terms) in Europe exceeded 24% for the year, with France showing a 35.6% return and Germany, a 40.7% gain. Indeed, both these countries experienced record U.S. equity inflows during 1989, as U.S. investment in French equities totalled

U.S. Direct And Portfolio Investment In The EC



$1.1 billion while German investment totalled $831 million. Underscoring the interest in these two countries is interest in these markets by all foreign investors. German shares were the recipients of net equity inflows of over DM23 billion, over 55% greater than 1986's DM15 billion. In France, portfolio investment in 1989 reached FFr190.6 billion, almost triple the previous year.

The real disappointment for U.S. investors must have been their $1 billion commitment to the Tokyo equity markets. U.S. investors saw returns (U.S. dollars) on their Japanese investment rise a lackluster 3%. Furthermore, we note that the double-barraled impact of declining equity prices and a weakening Yen reduced the value of U.S. investors' Japanese equity investments, in U.S. dollar terms, by over 35% during the first quarter of 1990.

David G. Strongin
Director, International Finance

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS BY FOREIGN INVESTORS
($Mils.)

	1988		1989		% CHANGE IN GA 1988-1989
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	
EUROPE	**$51,830**	**$15,149**	**$67,299**	**$13,637**	**29.8%**
BELGIUM-LUXEMBOURG	2,104	(171)	2,976	(1,212)	41.4%
FRANCE	2,334	75	2,447	467	4.8%
GERMANY	4,053	990	3,680	(50)	(9.2%)
SWITZERLAND	3,740	346	3,868	(38)	3.4%
UNITED KINGDOM	35,226	12,452	49,209	13,149	39.7%
ASIA	**24,964**	**5,068**	**32,412**	**2,060**	**29.8%**
JAPAN	24,330	4,864	25,734	786	5.8%
"OTHER ASIA"	2,226	(204)	3,711	1,045	66.7%
TOTAL ALL COUNTRIES*	**$87,702**	**$21,914**	**$117,885**	**$19,497**	**34.4%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

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SIA

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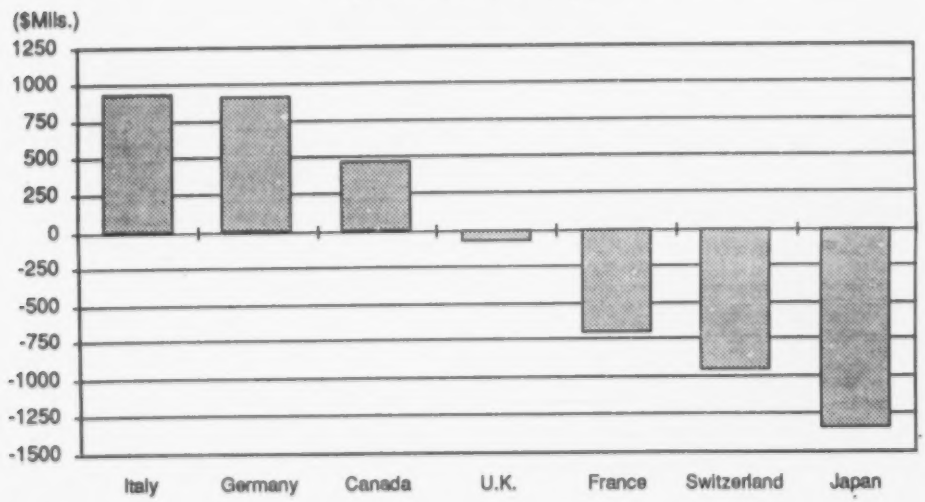
U.S. Investor Interest In Foreign Markets: Spreading The Wealth

Due to significant net sales in Japan, France and Switzerland, amounting to nearly $3 billion, U.S. portfolio investment was a rather modest $355 million during 1Q90. This is sharply below 1989's feverish pace, when net purchases averaged nearly $3.5 billion per quarter. However, we believe the net outflow figure in 1Q90 is misleading and we cannot conclude that U.S. investors are returning to their past lukewarm attitude towards foreign equities. Instead, net activity seemed to reflect the shifting of large pools of assets from one country to another as U.S. investors sought to take advantage of rapidly shifting investment opportunities; record quarterly gross transactions of over $72 billion support this notion.

Net Activity In Foreign Equities By U.S. Investors During 1Q90



Investment In Europe

Despite a $900 million sell off of Swiss equities, and an additional $700 million in the French market, net investment in Europe totalled $505 million. U.S. money contin-

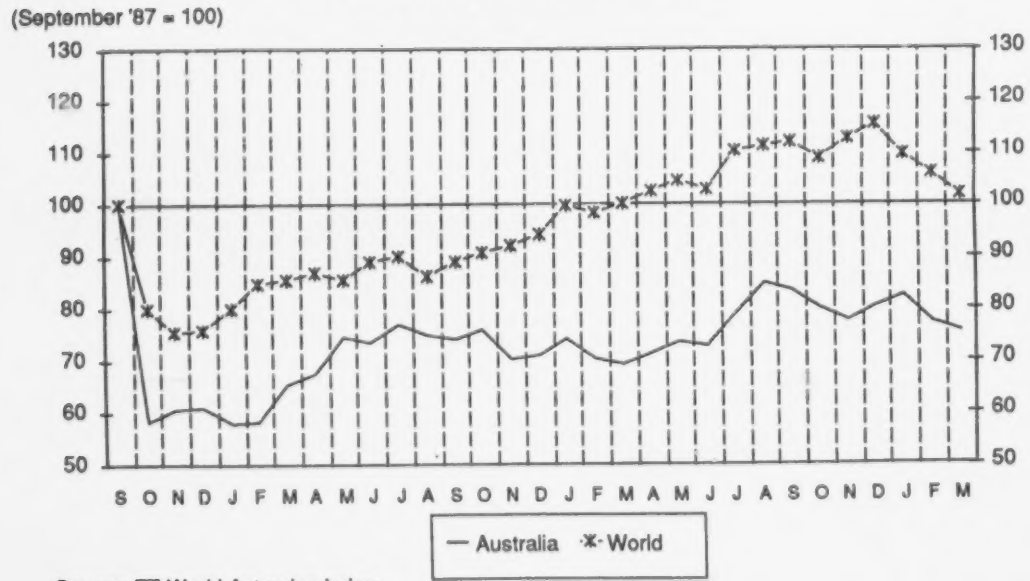
ued to pour into Germany during the first quarter of 1990, with net purchases reaching a record $903 million, nearly $400 million above the previous quarter's high of $555 million. The 1Q90 also marked a record high in terms of gross activity. At nearly $4 billion, U.S. investors easily exceeded the previous high of $2.7 billion reached in 2Q87. As mentioned in a previous issue of *ICMR*, total net foreign investment in West Germany in 1989 and the early parts of 1990 has been nothing short of spectacular.

Another EC country, Italy, was the recipient of $931 million in U.S. funds. With Italian equity prices showing weakness during 1Q90, U.S. investors may have seen this as a buying opportunity. In addition, U.S. investors paid little attention to Italy during the second half of 1989 and 1Q90 investment may reflect allocation decisions. This record inflow may have also been in anticipation of measures to be taken by the Italian Government, such as elimination of the last restrictions on cross-border capital flows (May 1990) and the liberalization of bank branches for foreign firms. In addition, in February of 1990, the Italian SEC opened the way for the quotation and trading of foreign equities on the Milan Stock Exchange. As has been the case in other EC countries, U.S. investors seem to be concentrating large sums of equity capital in hopes of benefiting from a European economic renaissance.

From South Of The Border To Down Under

U.S. investors took an extraordinarily positive attitude in Mexico and Australia during the first quarter. The Australian market never seemed to recover from the 1987

A Look At Australian Equity Prices
Nearly Three Years After The Crash



Source: FT-World Actuaries Index

market crash. For instance, equity trading volume in 1989 was $44.8 billion, down 23.9% from 1987's $58.9 billion. This compares to a 27.4% increase in world equity trading volume. Similarly, Australian market capitalization ended 1989 at $136.6 billion, some 20% less than the $171.8 billion at the end of 1987. During this same period, world equity capitalization expanded some 48% to $11.7 trillion. Indeed, Australia is one of only two developed markets not to yet rebound from 1987 levels. So, by most measures, the post-crash performance in the Australian market has been lackluster, with Australian equity prices still 20% below its September 1987 levels. U.S. investors may have seen a buying opportunity in this market. Net purchases at $273 million in Australia were double that of any previous quarter.

Looking South of the border, where Mexican equity prices (U.S. dollar terms) soared over 18%, U.S. net purchases of Mexican securities totalled $86 million during 1Q90. It is possible that the market-oriented policies of the Salinas government, such as the privatization of state enterprises and tax reform measures, may be enticing those U.S. investors looking for above average returns. In addition, while no evidence we know of exists, this may also indicate the return of "flight capital" to Mexico. Talk of a possible U.S./Mexican Free-Trade Agreement (Mexico happened to be our third largest trading partner in 1988) may spur additional inflows.

With the number of the countries receiving significant amounts of U.S. investment widening, the U.S. investor seems to be looking to further diversify his portfolio while looking for high growth opportunities to bolster returns. Countries which move along the path of stability and market-based economies, such as Mexico, Spain and Italy, will reap the rewards of foreign investment. Also, the U.S. investor may finally be a willing player in the international investment arena.

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Foreign Activity

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The Times They Are A-Changin'

As noted in a recent issue of the *Foreign Activity Report,* new investment opportunities worldwide will increasingly vie with the U.S. for the available supply of capital. Moreover, we speculated that this could lead to a diminished supply of capital for the U.S.—capital which otherwise would finance the U.S. deficit, support capital investment, etc. In 1989, this was already becoming evident as Japanese inflows of $6.4 billion were at their lowest level since inflows of $3.1 billion in 1983.

Indeed, in 1Q90, despite a stable dollar, foreign investors were net sellers of U.S. securities for the first time since 3Q83. Net sales of U.S. securities totalled over $4 billion in 1Q90, compared to $800 million in 3Q83. In sharp contrast to 3Q83, when OPEC's net sales of treasuries resulted in a net outflow of capital, 1Q90 saw a broad-based pattern of selling by geographical area and type of security.

Foreign Net Activity in U.S. Securities
($Bils.)

	1Q90	*3Q83*
Equities	(3.3)	1.0
Treasuries	(6.5)	(1.9)
Corp. Bonds	3.4	0.3
U.S. Agencies	2.2	(0.2)
Total	(4.2)	(0.8)

While considerations outside of these new opportunities surely played a role in the foreign investors' posture, we believe this emphasizes that the U.S. can no longer count on an unending supply of foreign capital. Moreover, other countries which seek foreign capital, such as the LDCs, may have to move relatively more aggressively in the future to attract foreign capital.

Less Investment In U.S. Equities: A Cyclical Trend Towards Europe?

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS ($Mils.)

	FOURTH QUARTER 1989		*FIRST QUARTER 1990*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q90-4Q89*
EUROPE	**$50,995**	**($1,243)**	**$44,855**	**($1,317)**	**(12.0%)**
BELGIUM-LUXEMBOURG	3,826	306	3,823	209	(0.1%)
FRANCE	4,196	(816)	2,939	(305)	(30.0%)
GERMANY	3,207	(277)	3,105	149	(3.2%)
NETHERLANDS	1,899	183	1,588	(18)	(16.4%)
SWITZERLAND	9,687	(1,195)	7,634	(922)	(21.2%)
UNITED KINGDOM	25,416	440	22,793	(811)	(10.3%)
CANADA	**11,268**	**(736)**	**9,077**	**(253)**	**(19.6%)**
LATIN AMERICA & CARIBBEAN	**16,595**	**(353)**	**13,019**	**(497)**	**(21.5%)**
BERMUDA	3,671	(213)	3,018	(24)	(17.8%)
NETHERLANDS ANTILLES	5,085	(423)	4,275	(395)	(15.9%)
ASIA	**24,069**	**1,841**	**21,612**	**(1,080)**	**(10.2%)**
HONG KONG	2,285	(47)	2,590	4	13.3%
JAPAN	16,171	1,233	13,868	(702)	(14.2%)
OIL EXPORTING COUNTRIES	4,452	492	4,000	(358)	(10.2%)
TOTAL ALL COUNTRIES*	**$105,192**	**($412)**	**$90,571**	**($3,299)**	**(13.9%)**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Higher interest rates, a 4% price decrease in U.S. equities (7% decline in January alone), and opportunities elsewhere led foreign investors to make net sales of U.S. equities totalling $3.3 billion, the second largest selloff ever. Gross transactions totalled $90.6 billion, a 14% decrease from the previous quarter and well below 1989's quarterly average of $104 billion. Foreign investors have now pulled $3.7 billion out of the U.S. equity market in the last two quarters. Since the U.S. economic picture has not deteriorated significantly enough during this period to account for this decidedly negative posture, we believe the events in Europe are siphoning off equity capital previously invested in the U.S. While foreign investors will continue to invest in U.S. equity markets, we will not be surprised if it is more erratic than in the past.

The pullback was worldwide, as investors from Europe, Canada, Latin America and Asia sought non-U.S. investment alternatives. We note that all major geographical areas showed negative returns (local terms) during 1Q90, ranging from a small 0.4% decline in the Nordic countries to nearly 25% in Japan. European investors were the largest net sellers, with sales outpacing purchases by $1.3 billion. This marks the second straight quarter of European net sales; 4Q89 net sales totalled $1.2 billion.

Investors from the U.K. made net sales of over $800 million. Developments in Eastern Europe have certainly influenced the strategies of U.K. investors. According to the *Financial Times,* the U.K. is second among EC countries in the number of joint ventures entered in Poland and Hungary. Interest is also being diverted to EC countries. U.K. investors made net purchases of over $2 billion in German equities during 1Q90. Spain has also been a major beneficiary of U.K. investment: U.K. money managers were the largest investors in Spanish shares and property in 1989 (*Financial Times,* 6/25/90).

The Swiss made net sales of nearly $1 billion in 1Q90. These investors have now gone ten consecutive quarters without committing new monies, net, to U.S. equities. Aggregate net sales during this period were close to $9 billion. No ready explanation accounts for this divestment. Given the conservative nature of the Swiss investor, the October 19, 1987 crash almost certainly provided the initial reason for repatriating capital. In addition, changes in Swiss regulations have forced Swiss pension fund managers to increase domestic equity exposure from 5% to 7%. The uncertain economic environment after the crash may have prompted Swiss pension funds to raise cash levels by selling foreign equities.

Investors from France made net sales of over $300 million in 1Q90. Similar to investors from Switzerland, French investors seem to have shunned U.S. equities in the post-crash era. Ironically, starting in 2Q86 and up until the crash, French investors showed signs of becoming significant investors in the U.S. and made net purchases of $2.4 billion. With the crash as background, the pace of French deregulation, economic and political events in Europe, an explosion in the supply of French equity (in 1989 equity offerings totalled Ffr317 billion, over double 1988's Ffr157 billion), and one of the best performing economies in the EC, have given French investors good reason to concentrate on French and European investments.

Japanese investors, concerned over the rapid decline in the Tokyo market, made net sales of slightly over $700 million. This continues an erratic investment posture by Japanese investors in U.S. equities. Since the Yen/Dollar Agreement in 1985, Japanese investors had been avid purchasers of U.S. equities. During the period 4Q85 to 3Q88, these investors made net purchases in each quarter, totalling $20.7 billion. In the last year and a half, however, investment in U.S. equities has been much less predictable, with net sales occurring in three of the past six quarters.

The flow of capital to the U.S. in the mid- to late 1980's may have brought Japanese investors' holdings of U.S. equities to levels appropriate for portfolio diversification purposes. Combined with increased interest in direct investment, growing worldwide investment opportunities, and recent domestic events, these investors will continue to commit money to U.S. equities, but at a reduced level.

Foreign Investment In U.S. Treasuries: Greater Value Elsewhere

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

	FOURTH QUARTER 1989		*FIRST QUARTER 1990*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q90-4Q89*
EUROPE	**$375,121**	**$4,557**	**$364,112**	**$1,048**	**(2.9%)**
GERMANY	11,850	3,538	12,629	981	6.6%
SWITZERLAND	10,803	(1,321)	7,245	(539)	(32.9%)
UNITED KINGDOM	268,536	4,156	264,905	1,473	(1.4%)
ASIA	**534,701**	**1,153**	**547,733**	**(2,385)**	**2.4%**
JAPAN	464,395	1,379	473,761	(3,941)	2.0%
"OTHER ASIA"	23,361	(2,557)	20,654	2,938	(11.6%)
NONMONETARY INT'L & REGIONAL ORGANIZATIONS	**49,182**	**2,648**	**45,787**	**(809)**	**(6.9%)**
TOTAL ALL COUNTRIES*	**$1,044,624**	**$7,206**	**$1,023,489**	**($6,527)**	**(2.0%)**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

After record net purchases of near $55 billion in 1989, foreign investment in U.S. treasuries tumbled in 1Q90. Indeed, foreign investors made net sales of U.S. treasuries, $6.5 billion, for the first time since net sales of $1.4 billion were made in 3Q88. Central banks made net sales of close to $4.9 billion in 1Q90, while private investors accounted for net divestitures of $1.6 billion. Among the largest net sellers of U.S. governments were Canada, Japan, the Netherlands, Singapore and Australia.

The Relative Attractiveness Of U.S. Bonds Falls As Yield Spreads Become Increasingly Thin

(Basis Point Difference)

	Japan	*W. Germany*
'86	274	146
'87	417	204
'88	457	227
1Q'89	**466**	**233**
2Q'89	378	175
3Q'89	310	118
4Q'89	224	48
1Q'90	**145**	**-2**

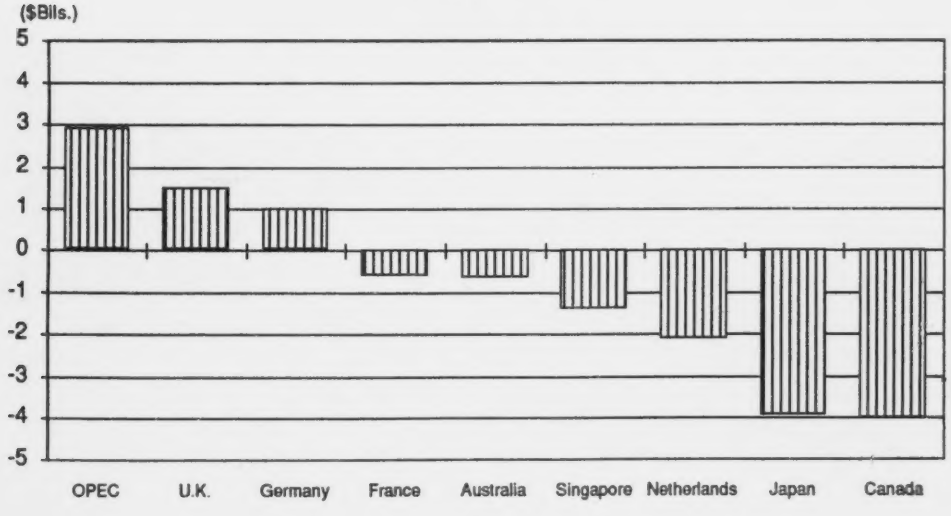
Source: Bank For International Settlements

First, after trending downward in 1989, rising U.S. interest rates in 1Q90, and uneasiness about possible rate hikes made these securities unattractive. In contrast, since the beginning of 1989, yields on foreign governments had been rising faster, closing the yield spread between U.S. governments and foreign governments and making foreign bonds more attractive. Moreover, this has occurred despite a U.S. inflation rate which is higher than many European countries. For instance, German governments actually yielded 2 basis points more than U.S. governments, the first time yields on German governments exceeded U.S. rates in 14 years. Yields on Japanese governments closed to less than 150 basis points, compared to spreads of over 450 basis points in late 1988.

Canadian investors took the most decidedly negative posture, with net sales of over $4 billion. A political dispute over the Meech Lake Accord, as well as a rise in Canadian yields, which increased the spread over U.S. treasuries to 200 basis points, gave ample reason to invest at home. Net sales of $3.9 billion from Japanese investors reflected activity by the Bank of Japan to counter the strengthening dollar and private investors' concern over the turmoil at home.

OPEC continued their resurgence in the U.S. treasury market by making net purchases of $2.9 billion. In that many countries seem to be lessening their exposure to the U.S. market, OPEC's return to the U.S. market comes at a welcome time.

Foreign Net Activity in U.S. Treasuries in 1Q90:
Going, Going, Gone



U.S. Investment In Foreign Equities: EC Bound

U.S. investment in foreign equities presented a mixed picture in 1Q90. Gross

transactions posted a modest 8.1% gain, to a record $72.8 billion. On the other hand, net purchases plunged to $355 million, well short of the $3.4 billion quarterly average in 1989. Investment in the EC was strong, totalling $1.4 billion. In addition, U.S. investors took a particularly global approach in 1Q90, making record net purchases in Australia and Mexico.

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

	FOURTH QUARTER 1989		*FIRST QUARTER 1990*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 1Q90-4Q89*
EUROPE	**$35,376**	**$2,484**	**$42,923**	**$505**	**21.3%**
EUROPEAN COMMUNITY	*$32,287*	*$4,911*	*$38,549*	*$1,464*	*19.4%*
BELGIUM/LUXEMBOURG	593	77	595	67	0.3%
DENMARK	78	26	251	57	221.8%
FRANCE	2,150	474	3,464	(706)	61.1%
GERMANY	1,897	585	3,775	903	99.0%
GREECE	8	4	10	4	25.0%
IRELAND	119	69	133	75	11.8%
ITALY	1,084	(18)	3,507	931	223.5%
NETHERLANDS	1,754	300	1,982	100	13.0%
PORTUGAL	41	37	14	10	(65.9%)
SPAIN	1,131	115	906	116	(19.9%)
UNITED KINGDOM	23,432	3,242	23,921	(89)	2.1%
SWITZERLAND	2,292	532	3,329	(963)	45.2%
CANADA	**2,815**	**511**	**2,879**	**461**	**2.3%**
ASIA	**20,693**	**869**	**20,647**	**(1,235)**	**(0.2%)**
JAPAN	17,696	1,084	17,705	(1,349)	0.1%
OTHER	**2,981**	**291**	**6,350**	**624**	**113.0%**
TOTAL ALL COUNTRIES*	**$67,354**	**$4,233**	**$72,799**	**$355**	**8.1%**

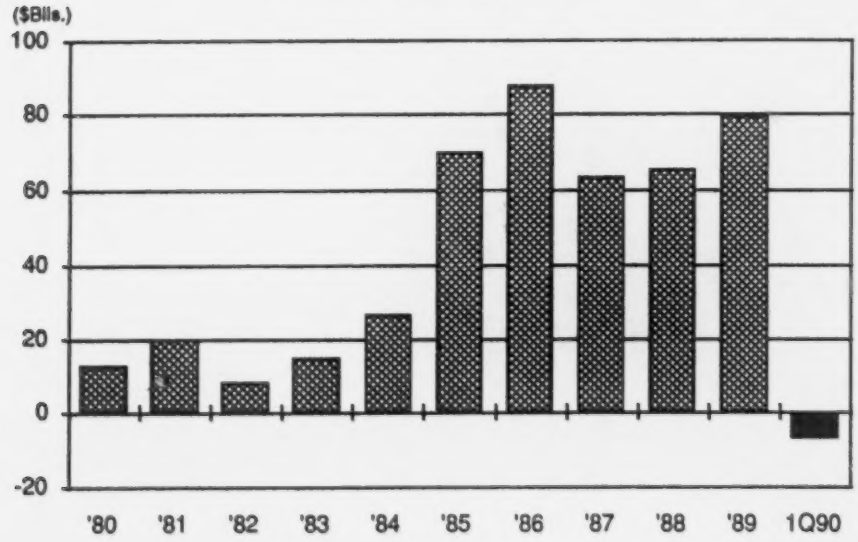
Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Investment in EC countries attracted the majority of U.S. interest. U.S. commitments to Italy and Germany totalled $931 million and $903 million, respectively. (See *Foreign Activity Report,* Vol. XIII, No. IV for details.) Indeed, outside of net sales of $700 million in France and less than $100 million in the U.K., net purchases were made in all other EC countries. U.S. Department of Commerce data underscores the growing U.S. commitment to Europe. Holdings of European equities climbed by nearly 60%, to $59.8 billion in 1989. Net purchases in 1Q90 indicate a readiness to increase exposure to Europe.

The main event driving international capital flows continues to be the increasing demand for capital. As *both* U.S. and non-U.S. investors look for new investments, the supply of capital available for the U.S. is diminishing. During the mid- to late 1980s, net capital inflows (foreign portfolio investment in the U.S. minus U.S. foreign portfolio

investment) averaged about $73 billion per year. In glaring contrast, the U.S. actually experienced net portfolio outflows of over $7 billion in 1Q90.

Net Portfolio Investment In The U.S.



As other countries have been attracting direct investment, the U.S. is now also competing for portfolio investment. Given the realities of a rapidly changing economic picture, foreign portfolio investment in the U.S. will be more erratic, and come at a greater cost than in the past.

David G. Strongin
Director, International Finance

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS BY FOREIGN INVESTORS
($Mils.)

	FOURTH QUARTER 1989		*FIRST QUARTER 1990*		*% CHANGE IN GA 1Q90-4Q89*
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	
EUROPE	**$18,041**	**$3,143**	**$14,478**	**$2,454**	**(19.7%)**
BELGIUM-LUXEMBOURG	979	(503)	695	(273)	(29.0%)
FRANCE	780	(74)	537	91	(31.2%)
GERMANY	932	32	970	(382)	4.1%
SWITZERLAND	1,189	(287)	719	282	(39.5%)
UNITED KINGDOM	12,566	3,572	10,251	2,661	(18.4%)
ASIA	**8,318**	**2,532**	**4,998**	**172**	**(39.9%)**
JAPAN	6,495	1,897	3,720	(84)	(42.7%)
"OTHER ASIA"	813	301	623	215	(23.4%)
TOTAL ALL COUNTRIES*	**$30,599**	**$6,737**	**$23,550**	**$3,402**	**(23.0%)**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

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The Party's Over?

The attractiveness of the U.S. markets to foreign investors in the 1990s appears to be on the wane, in sharp contrast to the 1980s, when foreign investors made record investments in U.S. securities. Given economic and political developments in Europe, and the global unease about the U.S. economy, foreign investors have, for the most part, stayed away from U.S. portfolio investments. Perhaps, those who warn against the evil of foreign investment may be relieved by this turn of events. However, the consequences for U.S. markets are real, higher interest rates and lower equity prices, to name just two.

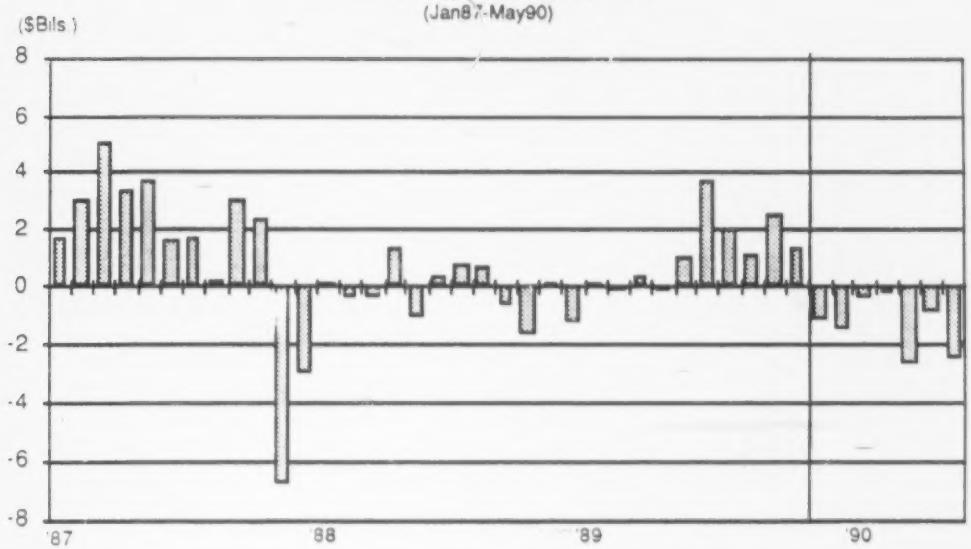
Foreign Net Activity In U.S. Securities

($Bils.)

	Jan-May 90	*Jan-May 89*
Equities	(6.7)	1.3
Treasuries	(5.9)	27.3
Corp. Bonds	5.5	8.4
U.S. Agencies	2.8	5.3
Total	(4.3)	42.3

In the last *FAR*, we noted that the U.S. experienced net foreign outflows for the first time since 3Q83. Preliminary data for April and May 1990 show foreign investors continue to shun U.S. securities. Foreign portfolio inflows totalled a meager $167 million during April and May. In large part, the positive direction of the flow results from net purchases of $2.3 billion in corporate bonds. While, in total, foreign investors also nibbled at U.S. Treasuries, with net purchases of $576 million, private investors made net sales of $2.1 billion.

Foreign Net Activity in U.S. Equities:
Can't They Spare Us A Dime



While net foreign investment in U.S. equities had been erratic in the post-crash era, a steady pattern of buying developed during May to October 1989. Since then, equities have fallen on hard times. After divestitures of $3.3 billion in 1Q90, net sales totalled an additional $3.4 billion for April and May. Indeed, foreign investors have made net sales for seven consecutive months, totalling $9.3 billion. This is a far cry from their posture during the 1980s.

Strikingly, the depth of the foreign sell-off in the past half-year has been much greater than after the events of October 1987. Certainly, the 1987 environment was different -- a strong U.S. economy, low inflation, an active takeover market and relatively high interest rates attracting foreign investors. However, we also believe a more fundamental shift in the foreign investors' attitudes to U.S. markets are taking place. This viewpoint is relatively more sanguine about the long-term prospects in several foreign equity markets compared to the U.S. market. In contrast, events in October 1987 were seen as short-term phenomenon and, therefore, no reason to significantly reduce U.S. holdings.

In fact, foreign investors had become a growing factor in the U.S. equity market by increasing their demand relative to U.S. investors. Foreign investors were an important foundation for U.S. equity prices in the 1980s, accounting for over 20% of all net purchases of U.S. stocks. Further underscoring the impact of the foreign investor was the reduction in supply of U.S. equities in the 1980s, which amounted to nearly $450 billion. Put another way, at the same time that foreign investors increased their demand for U.S. equities, the aggregate supply was diminishing giving foreigners an even larger impact on U.S. equity markets. The foreign pullback, combined with a reduction in takeover and corporate buyback activity, means that equities are losing two important pillars of price support in the 1980s.

Foreign Acquisition Of U.S. Equities
($Bils.)

	Institutional	Foreign ($)	Foreign (%)	Supply Of Equities
1980-1989	295.4	**62.5**	**21.2**	-449.4
1970-1979	150.3	**21.5**	**14.3**	78.5
1960-1969	71.8	**5.1**	**7.1**	15.1
1950-1959	18.0	**1.2**	**6.7**	18.0

Source: Federal Reserve; Goldman, Sachs & Co.

Not only has foreign interest in U.S. equities suffered due to new investment opportunities in other countries, but the recent rise in global interest rates has made equity investment less desirable relative to bonds. That this has not caused a shift by foreign investors to U.S. bonds is as much the result of foreign investor concern over the health of the U.S. economy, and the value of the dollar, as it is result of the relatively high interest rates investors can lock-in in their home market (without currency risk), or other foreign markets.

A Case Example: Japanese Investment

Japanese investors were major contributors to the U.S. capital markets in the mid-to-late 1980s. Japanese investors, beset by fears of inflation, rising domestic interest rates, and faltering equity prices have begun to reduce the high levels of overseas portfolio investment which have been common since the Yen/Dollar Agreement in 1984. Domestic concerns, combined with the tremendous growth in the holdings of foreign portfolio assets, suggest reduced portfolio investment in foreign markets over the next few years. In light of the traditional role of the Japanese financial intermediary in introducing Japanese investors to foreign markets, the implication for these firms may well be a squeeze on profit margins and a slowdown in expansion and personnel overseas.

Portfolio Flows

Japanese interest in overseas bonds, particularly U.S. Treasuries, has been widely noted. While their interest in foreign equities has also grown substantially, purchases of bonds clearly outweigh equity purchases. However, during the first quarter of the new decade, Japanese investors made net purchases of only $869 million in all overseas bonds, the lowest level since 1982.

In that the lion's share of Japanese bond purchases have been U.S. fixed income instruments, recent changes in the yield spread help explain the fall-off in bond purchases. Interest rates in Japan seemed to bottom out in April 1988, at below 4.0%. Since that time, however, interest rates have trended upward reaching 7.4% in March 1990, a 340 basis point increase. During this same period, U.S. rates actually declined 15 basis points, from just above 8.6% in April 1988 to 8.45% at the end of March 1990. In other words, Japanese investors now receive only a 100 basis point differential between Japanese and U.S. bond yields compared to over 500 in April 1988. Given the currency risk involved, plus worries over the U.S. inflation rate, U.S. bonds are not an attractive investment to Japanese investors relative to domestic bonds.

Indeed, with yields on U.S. and West German bonds roughly comparable, and with the DM strengthening, Japanese investors may increasingly look at German bonds. Recent events in the Middle East should, at least in the short term, force up interest rates in energy dependent Japan, further narrowing the existing spread between the U.S. and Japanese bond markets.

Moreover, investors from the U.K., Canada, Australia and other countries are finding yields on domestic bonds increasingly attractive. As the table shows, the lure of high yields has shrunk considerably on long-term U.S. Treasuries. For example, only one year ago, U.S. 10-year governments yielded 182 basis points more than German governments; the yield spread has since narrowed to 12 basis points. On bonds of shorter maturity, domestic bonds are even more attractive. Of the seven major investors in U.S. Treasuries, six can "lock-in" higher yields at home, and, for the other, the spread has narrowed considerably in the past year. This yield spread analysis helps explain both the current weakness in the dollar and the Fed's limitation to lower interest rates as a means of stimulating a lackluster economy.

Comparison Of U.S. Government Bonds
To Foreign Governments
(Basis Point Difference)

	1 Year		10 Year	
	May '90	*May '89*	*May '90*	*May '89*
Canadian	516	226	223	113
W. German	70	-182	-12	-182
U.K.	600	314	329	132
Swiss*	-170	-336	-235	-339
Dutch	82	-160	22	-145
French	126	-32	65	-11
Australian	641	622	487	477

*3 year; 1 year not available

Source: Salomon Brothers Inc

A review of the holdings of foreign securities by Japanese investors is also enlightening. At the end of 1984, Japanese investors held nearly $54 billion of foreign securities. The most recently available data (April 1990) shows holdings at $401.8 billion, a seven-fold increase. Of note, however, is that this is actually a decline from the $420 billion at year-end 1989. The reduction in holdings is a direct function of the declining value of the dollar and reinforces the substantial currency risk which Japanese investors have been subject to in the 1980s. Moreover, in 1984, before the Yen/Dollar Agreement had made its full impact, only 9% of Japanese securities holdings were foreign. In slightly over three years, this ratio had more than doubled to 18.6%. Since then, however, this ratio has remained more or less constant. For example, at the end of April 1990, this ratio had actually fallen to 18.2%. We suspect that due to the rapid accumulation of foreign equities and bonds that it is likely Japanese investors are growing comfortable with the ratio of foreign securities in their investment portfolios.

We have often expressed the view that foreign investment benefits both the U.S. and world economy. In the same vein, we have argued that attacks on foreign investment, which often border on the xenophobic, seem to be a clever way to avoid what must be done -- cuts in government spending and implementing tax policies that encourage savings. However, with concern over U.S. economic priorities given short shrift, those who have railed against foreign investment may finally have to confront U.S. economic realities.

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SIA

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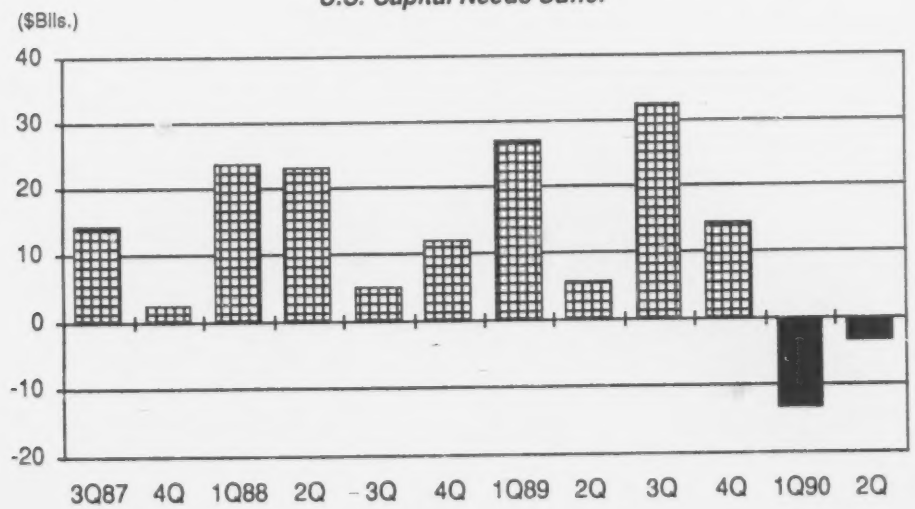
From Locomotive To Caboose?

With both the U.S. dollar and economy weakening, the U.S. capital markets experienced net portfolio outflows in 2Q90 for the second consecutive quarter. That is, $3.8 billion more in capital left the U.S. than came in, bringing the year-to-date outflow to $17.7 billion. Specifically, in 2Q90, U.S. investors made record quarterly net purchases of $11.5 billion of foreign securities, while foreign investors made net purchases of U.S. securities totalling $7.7 billion. Importantly, the major suppliers of U.S. capital in the 1980s, the Japanese, have accounted for more than half of all net portfolio outflows. In addition, and as we will discuss later, foreign direct investment has also been sharply curtailed. Given concern over a U.S. recession, combined with inflation and the likely continued weakening of the buck, foreign inflows cannot soon be expected to reach the levels achieved during the 1980s.

Net Portfolio Investment:
U.S. Capital Needs Suffer



The net portfolio outflows over the past two quarters have no doubt contributed to an already weak greenback, as well as the lackluster performance of U.S. securities markets. To put the U.S. capital drain in perspective, the reader need only look at the U.S. equity markets. Foreign and U.S. investors both have found non-U.S. equities of

growing interest. The combination of foreign investor net sales of U.S. stocks ($6.8 billion) and U.S. net purchases of foreign stocks ($6.2 billion) has reduced the potential demand for U.S. equities by some $13 billion during 1H90. In stark contrast, foreign investors were net buyers in 1987 of $16.3 billion while U.S. investors made net sales of $1.5 billion. This resulted in increased potential demand of $17.8 billion for the entire year. Given that the pricing of stocks is determined at the margin, we believe this double-barrelled impact has had major negative implications for U.S. equity markets.

Foreign Interest In U.S. Equities: "Neither A Borrower, Nor A Lender Be"

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1990		*SECOND QUARTER 1990*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q90-1Q90*
EUROPE	**$44,855**	**($1,317)**	**$42,694**	**($2,318)**	**(4.8%)**
BELGIUM-LUXEMBOURG	3,823	209	3,338	(570)	(12.7%)
FRANCE	2,939	(305)	3,582	(242)	21.9%
GERMANY	3,105	149	3,360	(118)	8.2%
NETHERLANDS	1,588	(18)	1,419	(129)	(10.6%)
SWITZERLAND	7,634	(922)	7,381	(767)	(3.3%)
UNITED KINGDOM	22,793	(811)	23,682	(426)	3.9%
CANADA	**9,077**	**(253)**	**9,178**	**(284)**	**1.1%**
LATIN AMERICA & CARIBBEAN	**13,019**	**(497)**	**13,051**	**49**	**0.2%**
BERMUDA	3,018	(24)	2,662	(92)	(11.8%)
NETHERLANDS ANTILLES	4,275	(395)	4,213	255	(1.5%)
ASIA	**21,612**	**(1,080)**	**22,987**	**(977)**	**6.4%**
HONG KONG	2,590	4	2,286	(128)	(11.7%)
JAPAN	13,868	(702)	16,057	(329)	15.8%
OIL EXPORTING COUNTRIES	4,000	(358)	3,511	(551)	(12.2%)
TOTAL ALL COUNTRIES*	**$90,579**	**($3,299)**	**$93,213**	**($3,529)**	**2.9%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Foreign investors, whose already diminished appetite for U.S. equities was further weakened by worries over an increasingly fragile U.S. economy, once again made net sales of U.S. equities. Net sales of $3.5 billion in 2Q90 pushed half-year divestment to $6.8 billion. In comparison, previous record net sales were "only" $2.9 billion (1984). Indeed, given the events of 3Q90, 1990 may end with a reduction in foreign holdings of U.S. equities for the first time since 1984, and in significantly larger amounts.

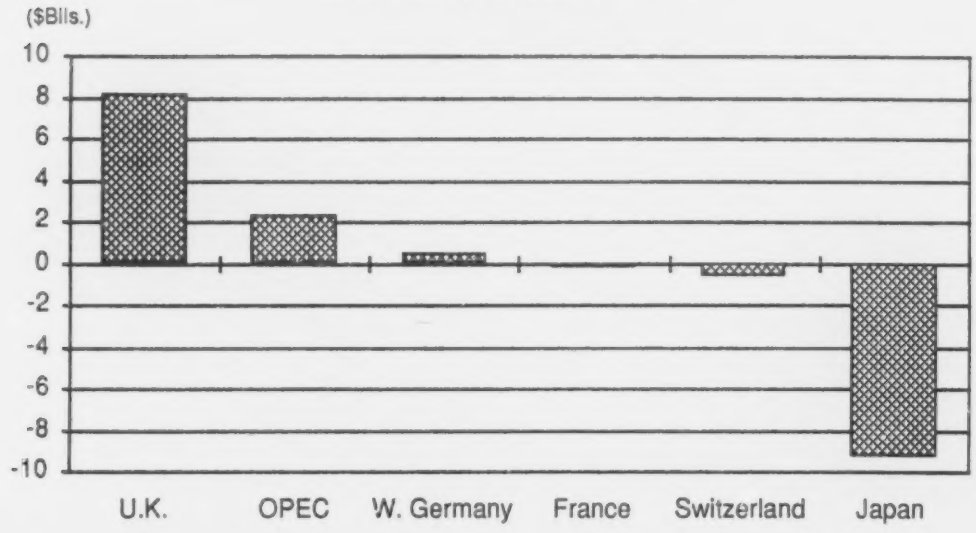
Gross activity in 2Q90 increased marginally to $93.2 billion, bringing the year-to-date total to $183.8 billion.

Foreign investors from all major geographical areas sold U.S. equities. While global investors have recently shunned U.S. equities to take advantage of non-U.S. investment opportunities, particularly in Europe, the precarious footing of the U.S. economy and dollar seems to be another substantial impediment to foreign interest in U.S. equities. European investors highlighted the "new" approach toward U.S. equities making net sales of $2.3 billion in 2Q90 compared to net purchases of $548 million in 2Q89. Indeed, every major European area made net sales of U.S. equities.

Japanese investors made net sales of $300 million, and over $1 billion for the 1H90. The investment posture of these investors has been increasingly determined by domestic economic troubles. Indeed, with Japanese interest rates increasing, equity prices declining 27%, and a rise in the Yen relative to the dollar, U.S. investments have become unattractive to these investors. And, as we've noted in the past, the rapid accumulation of U.S. securities in the 1980s may have also left these investors comfortable enough with the ratio of foreign securities in their portfolios that they no longer need look outside their home markets as they did in the past decade.

On a broader note, the Japanese investor, a prime supplier of U.S. capital in the 1980s, has taken a mirror-image posture in the 1990s. As the graph shows, in the 1H90, Japanese investors removed almost $10 billion in capital from the U.S. Not only did this have a negative impact on U.S. securities prices but we suspect that Japanese sales of U.S. securities, combined with a reduction in Japanese foreign exchange reserves from $91 billion at the beginning of 1Q90 to $66 billion at the end of 2Q90, led to a weakening in the dollar relative to the Yen.

Net Activity In U.S. Securities By Major Foreign Investors In 1H90



The aggregate data, though, masks the strong negative posture that these investors have taken in the U.S. Treasury market. Net sales of over $8.3 billion for 1H90 exceed that made by any other country and are in sharp contrast to the Japanese posture in the 1980s, when net purchasers were made in every year. Indeed, except for paltry net acquisitions of U.S. corporate bonds totalling $60 million, the Japanese have been net sellers of all other U.S. securities.

Foreign Investment In U.S. Treasuries:
A Departure From The U.S. Markets

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. TREASURY NOTES AND BONDS BY FOREIGN INVESTORS
($Mils.)

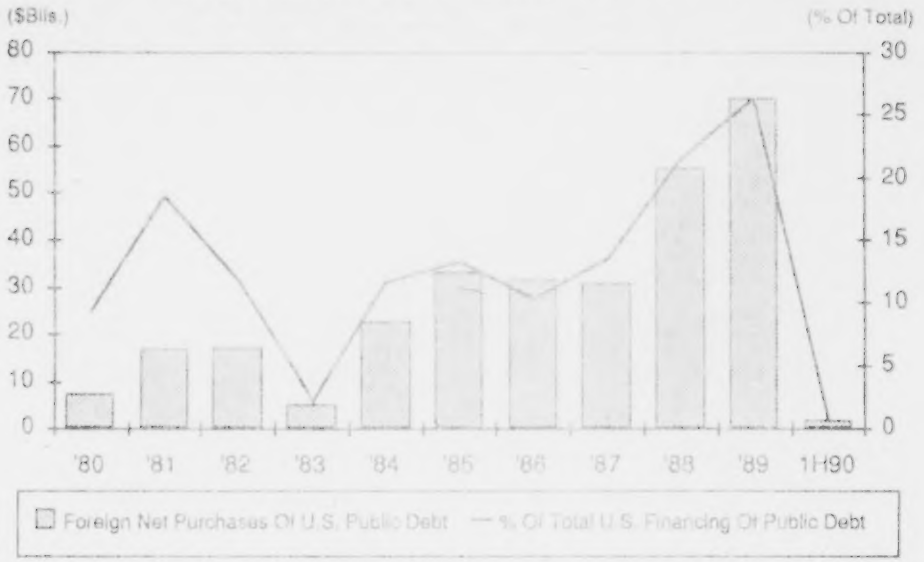
	FIRST QUARTER 1990		SECOND QUARTER 1990		% CHANGE
	GROSS ACTIVITY	NET PURCHASES	GROSS ACTIVITY	NET PURCHASES	IN GA 2Q90-1Q90
EUROPE	$364,112	$1,048	$336,453	$4,929	(7.6%)
GERMANY	12,629	981	16,221	(121)	28.4%
SWITZERLAND	7,245	(539)	8,889	839	22.7%
UNITED KINGDOM	264,905	1,473	242,569	579	(8.4%)
ASIA	547,733	(2,385)	495,521	(2,985)	(9.5%)
JAPAN	473,761	(3,941)	435,484	(4,370)	(8.1%)
"OTHER ASIA"	20,654	2,938	18,500	(74)	(10.4%)
NONMONETARY INT'L & REGIONAL ORG'S	45,787	(809)	51,192	(276)	11.8%
TOTAL ALL COUNTRIES*	$1,023,470	($6,520)	$940,387	$3,969	(8.1%)

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

Taking advantage of the U.S. bond rally in the latter part of 2Q90, foreign investors returned to the U.S. Treasury market, with net purchases of close to $4 billion. In sharp contrast to the European investor's attitude toward U.S. equities, their net purchases of U.S. Treasuries, $4.9 billion, more than accounted for all net purchases. In contrast, Japanese investors made net sales of $4.4 billion in 2Q90. Gross transactions fell to $940 billion, down 8% from the previous quarter's $1 trillion.

The foreign investors' hesitance to purchase U.S. public debt has a real impact on financing the U.S. deficit. During the period 1980-89, foreign investors made net purchases of U.S. public debt issued equal to 14%. In the 1988-89 period, this percentage was nearly 24%. In stark contrast, foreign investors took down only 0.3% of U.S. government issuance in 1H90. While we don't profess to know what this means in actual basis points, we believe that interest rates are certainly higher now than they would be if foreign investment were anywhere near earlier levels.

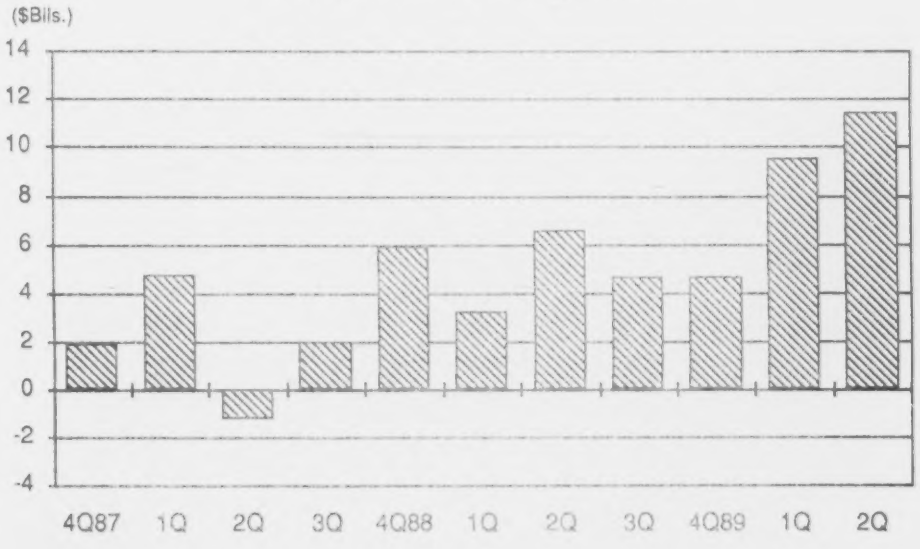
Foreign Interest In U.S. Public Debt Is On The Wane



U.S. Investment In Foreign Securities: A New Fixed Interest

U.S. investors outdid themselves in 2Q90, making record quarterly purchases of foreign securities totalling $11.5 billion. U.S. acquisitions were split almost equally between equities, $5.9 billion, and foreign bonds, $5.6 billion. Both were new records. First half 1990 totals are even more impressive, with U.S. capital outflows to overseas markets reaching $20.9 billion.

U.S. Net Purchases Of Foreign Securities



U.S. investors focused on EC countries and Japan. Except for net sales of $45 million in Belgium/Luxembourg and profit taking in West Germany, U.S. investors made net acquisitions in all other EC countries. The U.S. investment posture in West Germany, as well as that of other foreign investors, also reflected a growing realization of the economic problems that a unified Germany faces and less the euphoria cf quick economic gains. Data from the Deutsche Bundesbank underscores this point. To date, net equity inflows into West Germany total DM2.3 billion, a tenth of last year's inflows of DM23.3 billion.

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Mils.)

	FIRST QUARTER 1990		*SECOND QUARTER 1990*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q90-1Q90*
EUROPE	**$42,923**	**$505**	**$37,873**	**$3,315**	**(11.8%)**
EUROPEAN COMMUNITY	*$38,549*	*$1,464*	*$35,436*	*$2,820*	*(8.1%)*
BELGIUM/LUXEMBOURG	595	67	741	(45)	24.5%
DENMARK	251	57	157	31	(37.5%)
FRANCE	3,464	(706)	2,628	354	(24.1%)
GERMANY	3,775	903	4,652	(374)	23.2%
GREECE	10	4	8	2	(20.0%)
IRELAND	133	75	34	10	(74.4%)
ITALY	3,507	931	1,245	577	(64.5%)
NETHERLANDS	1,982	100	2,103	87	6.1%
PORTUGAL	14	10	14	8	0.0%
SPAIN	906	116	1,702	272	87.9%
UNITED KINGDOM	23,921	(89)	22,152	1,898	(7.4%)
SWITZERLAND	3,329	(963)	2,036	356	(38.8%)
CANADA	**2,879**	**461**	**2,399**	**(3)**	**(16.7%)**
ASIA	**20,647**	**(1,235)**	**19,129**	**2,087**	**(7.4%)**
JAPAN	17,705	(1,349)	16,225	1,763	(8.4%)
OTHER	**6,350**	**624**	**4,341**	**489**	**(31.6%)**
TOTAL ALL COUNTRIES*	**$70,756**	**$299**	**$64,192**	**$5,888**	**(9.3%)**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions

U.S. investors also purchased a record $1.8 billion in Japanese stocks in 2Q90. U.S. investors took advantage of the 25% drop (over 31% in U.S. dollar terms) in Japanese equity prices during 1Q90 by investing significant sums in the second quarter. While U.S. investors did miss out on the market's rise in the mid-1980s, the new investment pattern shows a willingness by U.S. investors to wade into the Japanese market given a "correction" in the valuation of Japanese equities.

We have recently chronicled significant U.S. investment in non-traditional markets such as Spain and Australia. Mexico has also received relatively large amounts of U.S. capital. The efforts by the Salinas government to renew the troubled Mexican economy

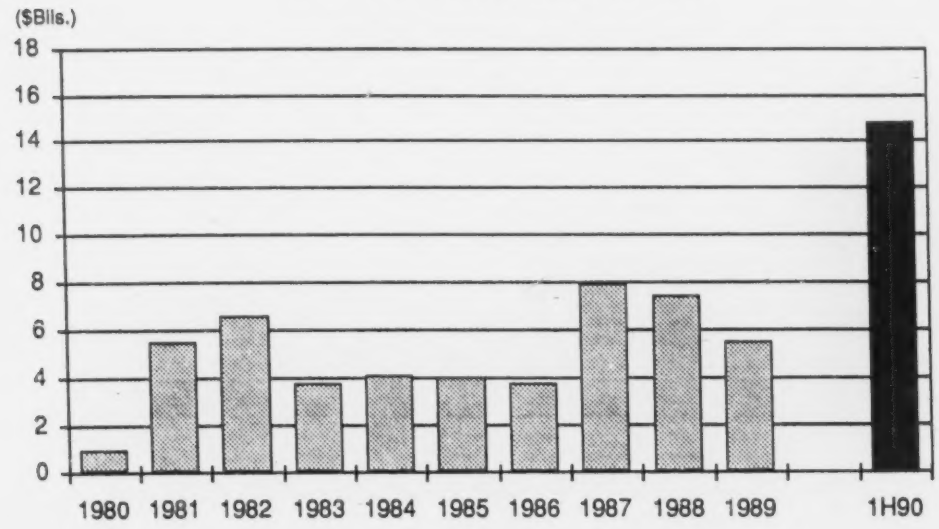
seems to be getting the okay from U.S. investors. Net investment in Mexican equities reached a record $300 million in 2Q90; this follows net acquisitions of $80 million in 1Q90. The U.S. posture toward Mexico, with the risks inherent in such investment, demonstrates the U.S. investors' increased interest in portfolio diversification as well as higher returns.

Main Beneficiaries Of
U.S. Net Equity Investment, 1H90
($Bils.)

U.K.	$1,974
Italy	1,508
Japan	414
Spain	388
Mexico	380

Of the five top countries receiving U.S. equity investment in the 1H90, only the U.K. and Japan would be considered mainstays of U.S. foreign equity investment. To put this in another perspective, in 1H90 over one-third of U.S. net foreign equity investment went to markets which account for only about 3% of the world's 1H90 equity capitalization.

U.S. Net Purchases Of Foreign Bonds

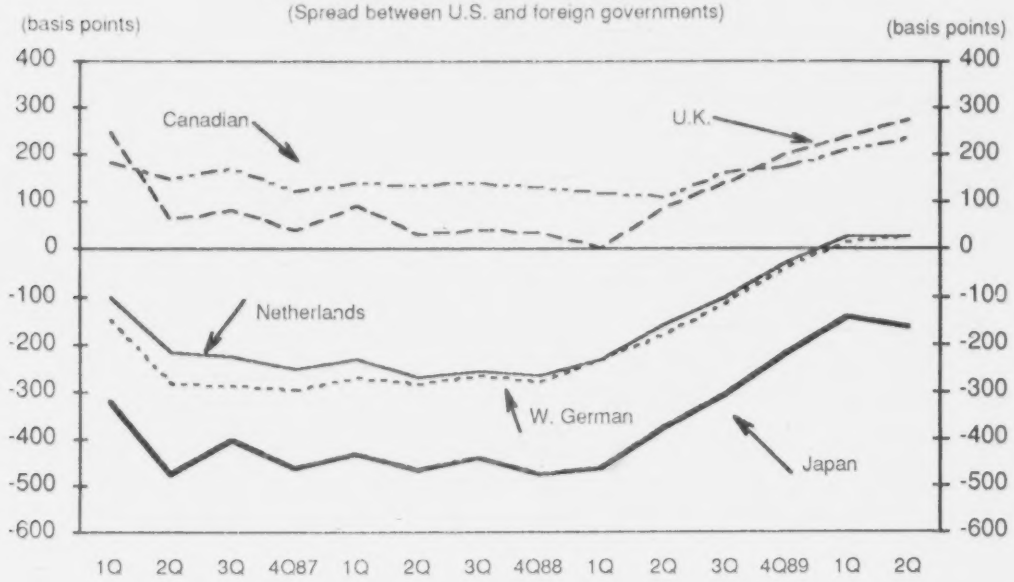


In 2Q90, U.S. net investment in foreign bonds totalled $5.6 billion. The 1H90 total of $14.7 billion was higher than any previous full year total. Higher yields overseas and

the prospect of a continued dollar weakening relative to foreign currencies bode well for overseas fixed-income investment. Indeed, by the end of 2Q90, U.S. governments had posted a small 2.1% return. In foreign markets, U.S. investors would have done far better. For example, a 8.95% return in long-term U.K. gilts or an 8.1% return in French governments. At shorter maturities, U.S. investors would have done even better.

U.S. Investors: In Search Of Higher Yields

(Spread between U.S. and foreign governments)



As noted earlier, the combination of foreign and U.S. outflows weakened U.S. securities markets in 1H90. Equally distressing, is the sharp curtailment in foreign direct investment. While still positive, direct purchases of U.S. assets in 1H90 were $10.5 billion according to the Department of Commerce's Office of Trade and Investment Analysis. This is just about a fourth of 1H89's record $38.4 billion, and the smallest amount since 1H86. The table below looks at both portfolio and direct investment and highlights the drastic falloff in total foreign investment.

Foreign Net Purchases of U.S. Financial Assets

($Bils.)

	1H90	*1H89*	*% Decrease*
Equities	$ (6.8)	$ 5.0	(236.0)%
Debt	10.1	37.3	(72.9)
Direct Investment	10.5	38.4	(72.7)
Total	$13.8	$80.7	(82.9)%

The curtailment in foreign direct investment contributes to lower securities prices in two ways. First, through decreased demand for these securities; and secondly, through the loss of the ripple effect, whereby large direct acquisitions often create increased value for other companies in the same industry which may become potential targets of foreign interests.

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GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS BY FOREIGN INVESTORS
($Mils.)

	FIRST QUARTER 1990		*SECOND QUARTER 1990*		
	GROSS ACTIVITY	*NET PURCHASES*	*GROSS ACTIVITY*	*NET PURCHASES*	*% CHANGE IN GA 2Q90-1Q90*
EUROPE	**$14,478**	**$2,454**	**$16,237**	**$3,679**	**12.1%**
BELGIUM-LUXEMBOURG	695	(273)	826	(458)	18.8%
FRANCE	537	91	817	(337)	52.1%
GERMANY	970	(382)	727	(5)	(25.1%)
SWITZERLAND	719	282	1,033	487	43.7%
UNITED KINGDOM	10,251	2,661	11,592	3,114	13.1%
ASIA	**4,998**	**172**	**4,960**	**510**	**(0.8%)**
JAPAN	3,720	(84)	3,723	141	0.1%
"OTHER ASIA"	623	215	546	184	(12.4%)
TOTAL ALL COUNTRIES*	**$23,816**	**$3,165**	**$25,723**	**$5,785**	**8.0%**

Source: U.S. Treasury
* Total activity incorporates revised data; country activity does not incorporate revisions